BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

Application of California-American Water Company (U210W) for Authorization to increase its Revenues for Water Service by $4,134,600 or 2.55% in the year 2011, by $33,105,800 or 19.68% in the year 2012, by $9,897,200 or 4.92% in the year 2013, and by $10,874,600 or 5.16% in the year 2014.	A.10-07-007 (Filed July 1, 2010)

OPENING BRIEF
OF THE DIVISION OF RATEPAYER ADVOCATES
[PUBLIC]

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I. INTRODUCTION

Pursuant to Rule 13.11 of the California Public Utilities Commission's ("Commission") Rules of Practice and Procedure ("Rules") and the direction of the assigned Administrative Law Judge ("ALJ"), Linda Rochester, the Division of Ratepayer Advocates ("DRA") files this Opening Brief in the General Rate Case ("GRC") of California-American Water Company's ("Cal Am") application for authority to increase its revenues for water service in each of its districts statewide by 2.55% in 2011, 19.68% in 2012, 4.92% in 2013, and 5.16% in 2014.

Pursuant to ALJ Rochester guidance to Seal portions of the transcripts and make certain exhibits confidential, DRA has redacted sentences which reference footnotes 308, 310, 313, 314, 327, 330, 332, 333, 334, and 336.

A. PROCEDURAL BACKGROUND

On July 1, 2010, Cal Am filed its GRC application, ("A.")10-07-007, to seek authorization for a general increase in rates for water service in its Larkfield, Los Angeles County, Monterey County, Monterey Wastewater, Sacramento, San Diego County, and Ventura County Districts. Protests to Cal Am's application were filed by Mark West Area Community Services Committee, the Monterey Peninsula Water Management District, and by DRA. As part of its protest, DRA recommended that the Commission schedule both evidentiary and public participation hearings to address numerous areas of concern. In particular, DRA was immediately concerned with the sheer magnitude of rate increases Cal Am was proposing, and the rate shock that would fall upon Cal Am's customers if approval of Cal Am's application was granted.[1]

[1] DRA Protest to Application of California-American Water Company (U210W) for Authorization to Increase its Revenues for Water Service by $4,134,600 or 2.55% in the year 2011, by $33,105,800 or 19.68% in the year 2012, by $9,897,200 or 4.92% in the year 2013, and by $10,874,600 or 5.16% in the year 2014, filed August 9, 2010.

The first prehearing conference ("PHC") was scheduled for August 26, 2010.[2] During the PHC, the parties discussed the scope of the proceeding, schedules, and locations for public participation hearings. DRA proposed a proceeding schedule that extended the period for settlement conferences and alternative dispute resolution ("ADR"). There were no objections to DRA's proposed schedule.

DRA filed several motions to compel in this proceeding, including on October 22, 2010, and January 27 and 31, 2011 to produce responses to data requests produced by Overland Consulting ("Overland"), an independent auditor retained by DRA to review Cal Am's books and records.

On February 1, 2011, as a result of Cal Am delaying its responses to many of Overland's data requests and preventing Overland from preparing many of the recommendations in its report, DRA filed a motion to extend the filing date of submission and service of Overland's staff report from February 18, 2011 to March 21, 2011. In its February 1, 2011 motion, DRA also submitted a proposed schedule revising some proceeding deadlines. A ruling by ALJ Rochester updating the proceeding schedule was provided to the parties on June 3, 2011 by e-mail and filed on June 10, 2011.

B. SUMMARY OF RECOMMENDATIONS

In accordance with Rule 13.11 of the California Public Utilities Commission's Rules of Practice and Procedure, DRA submits the following summary of recommendations:

- The Commission should only approve a revenue requirement of $685,000 to pay for the Toro Arsenic Treatment Plant.
- The Commission should disallow the Seaside Main replacements and a new Supervisory Control and Data Acquisition ("SCADA") system.

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[2] A.10-07-007, "SCOPING MEMO AND RULING OF THE ASSIGNED COMMISSIONER AND ADMINISTRATIVE LAW JUDGE", September 24, 2010, page 3.

- The Commission should impute the Domestic Production Activities Deduction on Cal Am for ratemaking purposes.
- The Commission should impute the maximum legal amount of bonus depreciation on Cal Am in 2011 for ratemaking purposes.
- The Commission should completely deny Cal Am's request to earn a full, weighted cost of capital return on all deferred regulatory balances on Cal Am's balance sheet.
- The Commission should deny Cal Am's request for a Business Transformation Memorandum Account.
- The Commission should not allow recovery of balances on the Monterey Water Revenue Adjustment Mechanism ("WRAM") Balancing Account and the Monterey Interim Rate True-Up ("MIRTU") Memorandum Account.
- The Commission should deny Cal Am's request to recover additional Toro-related Goodwill.
- The Commission should deny Cal Am's request for a billing system modification.
- The Commission should deny Cal Am's request to amortize all current and proposed balancing account balances in rates on an annual basis.
- The Commission should allow Cal Corp labor expenses only based upon the amount recorded in 2009. Alternatively, at a maximum, the Commission should authorize annually escalated labor and labor-related expenses based upon the Service Company's actual employee count at year 2010.
- The Commission should calculate pension expenses for test year, escalation year and attrition year based on an average of projected minimum funding requirements under the Pension Protection Act for the Period 2011 through 2016.
- Alternatively the Commission should adopt the Generally Accepted Accounting Principles ("GAAP") pension expense contribution,.
- The Commission should disallow Cal Am's requested Group Insurance Expenses that are recovered retroactively, beyond the industry average, or double counted.
- The Commission should allow the Business Transformation System into Cal Am's overall revenue requirement, but only under the conditions that total project costs be limited to the estimate the Service Company has provided; that the Commission impute at least a 5.3% reduction in business transformation costs that would otherwise be

allocable to American Water's market-based operations; and that the tangible project cost savings be imputed in the form of an expense offset.

II. DISPUTED ITEMS

A. Plant: Monterey County District

1. Special Request #19 – CAL AM's Request for Recovery of Toro Arsenic Treatment Plant

Decision 09-07-021 adopted a settlement agreement that required Cal Am to demonstrate the reasonableness of any spending in excess of $685,000 on the initial Toro Arsenic Treatment Plant ("Toro").[3] Cal Am's excess expenditures on this project were unreasonable for four reasons.

First, in spite of Cal Am's claim that the Pureflow project it selected is "cost-effective and preferable to all of the alternatives that California American Water evaluated",[4] Siemens Adsorbia is a cheaper alternative that meets the needs of the Toro system as well as Pureflow. Second, in rejecting the Siemens bid, Cal Am did not exercise the best engineering judgment. Third, even though Adsorbia met Department of Public Health requirements, Cal Am failed to even attempt to get a permit for it. Finally, even if Siemens had grossly under-estimated its operations and maintenance costs, as Cal Am wrongly claims, the Siemens' Adsorbia technology is still cheaper than the one Cal Am selected. Each of these points will be discussed in detail.

a) Adsorbia Is Significantly Cheaper Than Pureflow

To justify its rejection of Adsorbia, Cal Am claims that the Adsorbia technology is more expensive when combining capital and annual Operation and Maintenance costs.[5] However, the record shows that Adsorbia was the significantly cheaper overall option.[6]

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[3] D.09-07-021 at Page 129.

[4] Exhibit CAL AM-4, "Direct Testimony of Thomas Brunet" at Page 12.

[5] Exhibit CAL AM-49, "Rebuttal Testimony of F. Mark Schubert" at Page 165.

[6] May 27 Tr. 1059: 6-13.

The Table below shows the overall capital and operations and maintenance costs associated with each option.

Table 1
Comparison of Combined Capital and Operations and Maintenance Expense for Adsorbia and Pureflow Technologies

Treatment Technology	Capital Cost	Estimated Annual Operations and Maintenance Cost	Pre-Tax Annual Revenue Increase
Siemens Adsorbia Technology	$685,000[7]	$100,000[8]	$77,131[9]
Pureflow	$1,955,400[10]	$96,100[11]	$220,178[12]

As shown in the table above, the Pureflow technology capital cost is approximately three times that of the Adsorbia technology, while the estimated annual Operations and Maintenance costs are approximately the same for both technologies. The resulting pre-tax annual revenue increase resulting from the Pureflow technology is also almost three times of that associated with Adsorbia.

b) In Rejecting Siemens' Bid, Cal Am Did Not Exercise Best Engineering Judgment

In spite of Cal Am's claim that the Siemens Adsorbia technology would be operationally impractical because it requires excessive filtration media change-outs on an ongoing basis,[13] the record also shows that Adsorbia technology filtration media change-

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[7] Exhibit DRA-9, "DRA Testimony on Utility Plant in Service of California American Water Company Monterey County District and Toro Service Area, Including Special Requests 7, 15, and 19", Page 5-1.

[8] Exhibit DRA-9, Page 5-8. As explained on Page 5-8, this estimate includes $88,500 to replace changeouts approximately once every 395 days, and $3,000 for backwashing once every three months.

[9] Exhibit DRA-9, Page 5-8.

[10] Exhibit DRA-9, Page 5-1.

[11] Exhibit DRA-9, Page 5-8.

[12] Exhibit DRA-9, Page 5-8.

[13] Exhibit CAL AM-49, Page 165.

outs would last approximately 395 days before requiring replacement.[14] An unusually high amount of silica, approximately 57 parts per million, exists in the Toro water supply, which factors into considering how often change-outs require replacement.[15] Nonetheless, Siemens was mindful of this fact when estimating the approximate lifespan of each change-out.[16]

Cal Am incorrectly contends at some length that Siemens over-estimated in its own bid how long its change-outs would last in the Toro system.[17] In particular, Cal Am asserted in discovery that it dismissed the Siemens bid because another Vendor, Severn & Trent, stated its own different technology with a similar name (Iron oxide adsorptive media), would not be suitable for the Toro system.[18] In fact, Siemens' 395 day estimate was based upon a different titanium oxide based media.[19]

Cal Am goes on to claim in rebuttal that Dow's commercial publication should be relied upon to dismiss Siemens' estimate in its bid.[20] The real bottom line is that Siemens, a world renown and credible engineering company with an excellent reputation, used its best engineering judgment to provide a cheaper and viable treatment plant that did meet the needs of the Toro system. As DRA stated in testimony, "the best engineering judgment in this case would be from the actual bid proposal provided by Siemens to Cal Am which was tailored specifically for the on the ground site conditions, pumping requirements, and water chemistry at Toro".[21]

c) Cal Am Could See That Adsorbia Technology Brought Toro System Water Into Compliance With State Arsenic

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[14] Exhibit DRA-9, Page 5-12; May 27 Tr. 1060: 19-25.

[15] Exhibit DRA-9, Page 5-6.

[16] Exhibit DRA-9, Page 5-6.

[17] Exhibit CAL AM-49, Pages 167-8.

[18] Exhibit DRA-9 Page 5-4.

[19] Exhibit DRA-9, Page 5-5.

[20] Exhibit CAL AM-49, Pages 157-158.

[21] Exhibit DRA-9, Page 5-7.

Requirements, But Failed to Attempt to Get a Permit For It

Cal Am further claims in rebuttal that it did not select the Siemens bid because Siemens titanium dioxide based adsorption system had a highly uncertain permitting timeframe.[22] However, Cal Am itself acknowledges that such a system has been permitted once before in California.[23] Cal Am provides no reason why it could not have learned the schedule required to acquire this permit. Cal Am's argument is unpersuasive when one considers that the actual Toro Arsenic Treatment Facility was not operational until March 1, 2010, approximately two full years longer than the 90-day deadline to which Cal Am agreed.[24]

Moreover, Siemens particularly designed and tailored the Adsorbia system to address water chemistry in the Toro system. Specifically, it was known that Siemens designed its Adsorbia system to reduce arsenic levels in Toro water to below maximum contaminant levels required by the California Department of Public Health.[25] Nonetheless, in spite of DRA's direct questions during discovery, Cal Am did not even attempt to apply for a permit with the California Department of Public Health for the Siemens Adsorbia treatment technology.[26]

Given Cal Am's demonstrated lack of urgency to install the treatment facility, Cal Am had ample time to explore whether the Siemens' Adsorbia technology could have received a permit.

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[22] Exhibit CAL AM-49, Page 167.

[23] May 27 Tr.

[24] Exhibit DRA-9 at Page 5-9. This agreement was adopted by the Commission in D.07-11-034.

[25] May 27 Tr. 1059: 6-26.

[26] May 27 Tr. 1053: 26 to 1054: 9.

d) Even if Siemens Grossly Over-Estimated the Lifetime of Media Changeouts, the Siemens' Adsorbia Technology Is Cheaper

Cal Am claims that Siemens over-estimates how long the Adsorbia change-outs would last. To use an extreme hypothetical, even if Adsorbia changeouts lasted only half as long as Siemens experts expected, this would mean that the Adsorbia related O&M costs would be approximately double the estimated $100,000 per year. Even then, these somewhat higher O&M costs are substantially outweighed by higher capital costs of the Pureflow system -- almost $1.3 million more than the Siemens' Adsorbia capital costs. Therefore, the record still shows that Adsorbia is cheaper overall than the other system.

For all of the reasons mentioned above, the Commission should only approve a revenue requirement of $685,000 to pay for the existing Toro Arsenic Treatment Plant. However, DRA recommends allowing the O&M estimate for the Pureflow system into rates.

2. Seaside Mains

Cal Am's Seaside Mains are not properly justified for several reasons. First, contrary to Commission requirement,[27] Cal Am claims that the current Seaside Main replacement projects are a continuation of an investment project approved by the Commission in the 2008 General Rate Case.[28] Second, Cal Am has not followed Commission requirements because it has failed to provide a Condition Based Assessment that gives adequate information or analysis to justify pipeline replacements such as the Seaside Mains. Third, according to Cal Am's own standards, the Seaside Mains do not have enough breaks to make it cost-effective to replace them. Finally, Cal Am should explore the feasibility and cost-effectiveness of alternative technologies in achieving the goal of preserving infrastructure assets such as the Seaside Mains. Each of these points is discussed below.

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[27] This requirement is specifically explained in the section below.

[28] Exhibit CAL AM-49, Page 120.

a) Cal Am's Claim that the Current Seaside Main Replacement Projects Are A Continuation of A Previously Authorized Investment Project Runs Counter to Commission Requirements

Cal Am claims that its request is a continuation of an investment project approved by the Commission in the 2008 GRC,[29] and that it makes no sense to cancel this project.[30] However, the 2008 decision that authorized Seaside north and south replacements explicitly stated that "The pipeline should be replaced over the three-year rate case period, and rate base increases for each year *shall* be limited to no more than $2.4 million for these replacements."[31] In light of this requirement, this additional Seaside Main Replacement is not a continuation of the previously authorized Seaside replacements, but a request for additional money beyond the $2.4 million allocated in the last GRC for a different section of main.

b) Cal Am's Condition Based Assessment Is Inadequate to Justify the Seaside Mains

Cal Am rightly states that the Seaside Main replacements are included within Cal Am's 2009 Condition Based Assessment of Buried Infrastructure ("CBA"). However, DRA's concern is that this CBA fails to heed prior Commission requirements for improved data collection and analysis in order to justify future pipeline replacement proposals such as the proposed Seaside Main replacements.

In D.09-07-021, the Commission stated:

> "Spreading [the] estimated $7.1 million Seaside project over the three year rate case period will create a gradual stepping up of rate base and resulting increase in revenue requirement, while allowing the project to go forward with certainty. This time period will also allow Cal-Am to improve its data

[29] Exhibit CAL AM-49, Page 120.

[30] Exhibit CAL AM-49, Page 124.

[31] D.09-07-021, Page 40.

> collection on breaks and prepare a more system-specific pipeline replacement program for future general rate cases. *Improved data collection and analysis will be essential to justifying any future pipeline replacement proposals.*"[32]

Cal Am's CBA lacks the data collection and analysis that the Commission deemed essential to justify pipeline replacement proposals such as Seaside mains in at least several critical areas. First, Cal Am failed to provide any documentation of leaks occurring during the last three years on the sections of Seaside mains it sought to replace in this rate case.[33] Second, Cal Am's CBA did not identify the amount of nonrevenue water or water loss reductions Cal Am would anticipate from the main replacement programs it has proposed.[34]

c) By Cal Am's Own Professed Standards, Replacing Its Seaside Mains Is Not Cost Effective

In the last rate case, Cal Am took the position that the

> "critical break rate" for 4" to 8" mains in Monterey was five breaks per mile per year.[35] However, the average break rate for the last 15 years on the Seaside Mains requested for replacement is well below the critical break rate. Instead, the Seaside Mains have failed at a rate of only 1.2 breaks per mile per year.[36] Therefore, it is not more cost-effective to replace the Seaside mains than to repair current breaks in those mains.

For all of the reasons mentioned above, the Commission should not allow the Seaside Main replacements in rates.

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[32] D.09-07-021, Pages 39-40.

[33] Exhibit DRA-9, Page 1-55.

[34] May 27 Tr. 1058: 15-19.

[35] Exhibit DRA-9, Page 1-55. FN 137 on this page states that "The 'critical break rate' is defined as the rate of main breakage at which it is more cost effective to replace the main instead of continuing to repair the breaks.

[36] Exhibit DRA-9, Page 1-55.

3. SCADA

California American Water has requested almost $2 million in funding to update its existing functioning SCADA system. In spite of Cal Am's request, the upgrade is not merited.

a) The Existing SCADA System Adequately Meets the Needs of the Monterey System

Cal Am's argument for a brand new $2 million SCADA system is premised on several claims. First, some pieces of the existing system are past their life expectancy, and will fail at some unidentified future time.[37] Second, a minority of the Monterey district lacks SCADA coverage which the new system will address.[38] Third, DRA's analysis that as few as only five daily alarms from the existing SCADA system actually seem to require operator attention somehow misses the point of the value the SCADA system actually provides.[39] Fourth, the system is now running with a single "Iconics" software platform.[40] While providing extensive technical jargon about this point, Cal Am fails to explain why it follows that this last point means that a new system is necessary.

DRA does not dispute the value of the existing SCADA system to Cal Am's operations. However, DRA is concerned about numerous rate hikes Monterey District ratepayers will experience related to removal of the San Clemente Dam, construction of the regional desalination project, and under-collection in the water revenue adjustment mechanism that could end up as another surcharge on customers' bills.[41] DRA is particularly sensitive to these financial pressures experienced by so many Monterey district ratepayers,[42] particularly during these difficult economic times.[43] In light of this,

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[37] Exhibit CAL AM-49, Pages 116-117.

[38] Exhibit CAL AM-49, Page 117.

[39] Exhibit CAL AM-49, Page 117.

[40] Exhibit CAL AM-49, Page 117.

[41] May 27 Tr. 1057: 2-17.

[42] May 27 Tr. 1057: 18-20.

DRA considers projects that address public health and safety needs or meet regulatory compliance ones that merit higher priority.[44] None of the reasons Cal Am has provided above seem to fall into those higher priority categories.

Moreover, Cal Am did not explain how the enhanced SCADA system could be used in monitoring non-revenue water.[45] Such an explanation may have given DRA a basis to evaluate whether such savings could adequately offset the costs of a brand new system.

b) The Existing SCADA System Already Receives Funding

Cal Am has incorrectly contended that DRA disfavors any additional investment in the SCADA system.[46] In fact, the record shows that DRA has recommended approval of Cal Am's request for approximately $320,000 in recurring projects from 2009-2014 for SCADA equipment and systems.[47] In light of this recommendation, DRA maintains its position that a completely new system is unnecessary at this time, and that Cal Am has not proven any significant benefit to systems operations or labor cost reductions.[48]

For all of these reasons, a new SCADA system is not merited during this General Rate Case, and the Commission should reject Cal Am's request.

4. Special Request #32 - Monterey Billing System Modification Costs

Cal Am requests $960,000 in estimated capital additions in 2010 for "enhancements to the ECIS billing system to calculate and track usage allotments by account for residential, nonresidential and dedicated irrigation customers."[49] Cal Am

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[43] May 27 Tr. 1058: 1-3.

[44] May 27 Tr. 1057: 23-27.

[45] May 27 Tr. 1055: 27-28 and 1056: 1.

[46] Exhibit CAL AM-49, Page 116.

[47] Exhibit DRA-9, Page 1-53.

[48] Exhibit DRA-9, Page 1-53.

[49] DRA Exhibit 9, page 1-6.

goes on to claim that, "the project goal was to begin billing customers with revised rates by October 1, 2008. The capital amount of $720,500 was approved in D.09-07-021. Software vendor, Vertex, was contracted to update the billing system modifications for $632,550."[50] However, D.09-07-021 provided no approved capital amount of $720,500 as claimed by Cal Am. In fact, during the last Monterey District GRC, Cal Am had only requested **$450,000 of A&G expenses related to rate design changes.**[51] During discovery, Cal Am admitted that its statement regarding previous capital plant requests and approval of those requests was mistaken.[52]

According to the direct testimony of Dave P. Stephenson, which contradicts Cal Am's statements above, "D.09-07-021 failed to address recovery of the cost of the billing system modifications." On December 18, 2009, Cal Am filed a Petition for Modification of D.09-07-021 requesting that the Commission allow Cal Am to recover an estimated $945,720 in billing system modification expenses via an advice letter submission. DRA strongly objected to Cal Am's request, stating that:

> "In A.08-01-027, Cal Am requested $450,000 to modify its billing system to incorporate rate design changes. The $450,000 was part of Cal Am's request for $3.2 million in regulatory expenses. On August 21, 2008, DRA issued its Report on the Results of Operation recommending that Cal Am be allowed $600,000 in regulatory expenses.**15** In its testimony, DRA noted that Cal Am's justification for the $450,000 to modify its billing system was limited to one e-mail from an ITS Project Manager, that did not provide any specific information, to support its $450,000 billing system modification cost request."[53]

DRA explains further in footnote 6 of its Response:

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[50] DRA Exhibit 9, pages 1-6 and 1-7.

[51] DRA Exhibit 9, page 1-7.

[52] DRA Exhibit 9, page 1-7.

[53] DRA did not specifically disallow billing system cost but instead forecasted total regulatory expenses using a macro approach by using a three year average.

> "D.09-07-021 granted Cal Am $350,000 a year or $1,050,000 total for regulatory expenses. The decision notes that it approved "Cal-Am's request for five full-time rate staff and three engineers, who will devote a portion of their time to regulatory matters" and noted that "Support Services, such as information technology necessary to implement billing changes, are also funded through the service companies." (D.09-07-021, pp. 74-75.) Thus Cal Am has received some compensation for the billing system changes."[54]

In the last GRC, Cal Am already had an opportunity to forecast the A&G expenses it would incur due to rate design changes and the Commission ruled on those matters, including billing system modifications. Thus, Cal Am has already received recovery for justified A&G expenses associated with the billing system modifications, as determined appropriate by the Commission in D.09-07-021. In D.10-11-006, the Commission reiterated its position by denying Cal Am's petition for modification related to the billing system modifications advice letter request, stating that, "The Commission does not implicitly and unilaterally impose additional terms on settlement agreements."[55]

In this GRC, Cal Am seeks to reclassify the A&G expenses it booked in late 2009 and 2010 into utility plant in service for addition to ratebase. DRA strongly opposes Cal Am's request which would run counter to a number of Commission decisions, policies and procedures. Billing system modifications for rate design changes were properly classified in the last GRC as an A&G regulatory expense and not as utility plant in service. These expenses were forecasted in the last GRC and the Commission ruled on those forecasts in D.09-07-021, which adopted $1.05 million in regulatory expenses, and D.10-11-006, which denied Cal Am's request for additional regulatory expenses. Allowing additional A&G regulatory expenses into plant in service and thus ratebase in this GRC would constitute retroactive ratemaking, run counter to Commission practices

[54] Exhibit DRA 9 page 1-8.

[55] D.10-11-006, page 4.

and procedure, and cause double recovery of the forecasted costs for rate design changes. [56]

Furthermore, Cal Am provides no new, substantive information to support its request in this GRC that was not already provided in its Petition for Modification of D.09-07-021. In that Petition, Cal Am provided a 173 page Business Requirements Document (BRD) prepared by Vertex Business Services. In this GRC application, Cal Am provides largely the same document, with minor modifications relating to estimated delivery dates, removing the confidentiality notice, and replacement of Vertex Business Services with Orcom Solutions, Inc. Since the document changes are largely non-substantive, Cal Am provided no new information for the Commission or DRA to review in support of Cal Am's new request in this GRC vis-à-vis Cal Am's previous Petition for Modification filing. Cal Am provides the a truncated version of the BRD in its capital project workpapers, with the only additional information relating to project invoices from Vertex Business Services. Therefore, Cal Am has not provided any material information that differs from its previous Petition for Modification request, which the Commission already rejected. Cal Am's attempt to reclassify the billing system modification A&G expense as utility plant in service, which is based upon no new facts or evidence, should be dismissed by the Commission.[57]

Finally, Cal Am's request subverts the rate case process. Allowing Cal Am to reclassify a properly recorded A&G expense (which was a part of the last GRC regulatory expense forecast) as utility plant in service for inclusion into ratebase would open the door for Cal Am to re-litigate (and likely double recover) any expense that Cal Am decided at a later date to classify as a capital plant addition.[58]

For all the aforementioned reasons, DRA strongly recommends that the Commission deny Cal Am's request related to Cal Am's Special Reques

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[56] Exhibit DRA 9, pages 1-8 and 1-9.

[57] Exhibit DRA 9, page 1-9.

[58] Exhibit DRA 9, page 1-10.

B. Income Tax & Tax Related Issues

1. DPAD

The Commission should impute the Domestic Production Activities Deduction ("DPAD") on Cal Am because the company anticipates collecting $12 million in rates for income taxes. Cal Am relies exclusively on D.09-03-007 ("Suburban decision") as the basis to claim the Commission should not impute DPAD.[59] However, if the Suburban decision applied to Cal Am in this GRC, it would give all water utilities the opportunity to prevent the Commission from imputing DPAD or other income tax deductions ever again. This will be explained below.

Cal Am cites to the Suburban decision for the notion that a company which shows a net operating loss should not have DPAD imputed, because no DPAD would exist in such a situation.[60] However, Cal Am fails to note that the Suburban decision found it unnecessary to impute DPAD on Suburban Water Company ("Suburban") in the Suburban decision because the company showed an overall loss on returns.[61] Unlike with Suburban, Cal Am anticipates paying approximately $12 million in total income taxes in 2012, thus demonstrating Cal Am is making a healthy profit.[62]

Cal Am's next argument falls outside the scope of the specific holding of the Suburban decision. However, Cal Am still claims that the Suburban decision should apply. Namely, Cal Am now wishes to carry forward net operating losses from prior years to 2012 in the hope that the Commission will not impute DPAD. The danger of accepting such an approach is that it would suggest to other California water utilities that they could simply sprinkle just enough net operating loss carry forwards into each test and escalation year to avoid showing any income tax for ratemaking purposes. Under this new standard, if a company accounted for its net operating loss cleverly, it could

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[59] Exhibit CAL AM-42, Page 6.

[60] Exhibit CAL AM-42, Page 6.

[61] D.09-03-007, Page 19.

[62] May 31 Tr. 1145: 22-27. See also Exhibit DRA-32 (As noted in that exhibit, this is at proposed rates.)

prevent the Commission from imputing DPAD, or any other tax deductions ever again. Allowing this practice could not possibly have been the intent of D.09-03-007. The Commission should send a strong message that this gaming of the system is unacceptable by imputing DPAD based upon the approximate $12 million income tax Cal Am anticipates paying in 2012.

2. Repairs Deduction/ FIN 48

DRA defers to TURN on this issue.

3. Bonus Depreciation

The Commission should impute the maximum legally allowed amount of bonus depreciation on Cal Am in 2011 because Cal Am has taken bonus depreciation every other year it could, and because Cal Am provides no reasons to distinguish 2011 from any of the other years it took bonus depreciation.

The record consistently and unwaveringly supports imputing bonus depreciation on Cal Am in 2011. First, Cal Am has claimed bonus depreciation in every other year it could in the past, and intends to do so again in 2012, and offers no rationale to explain why 2011 is different than those other years. Second, the record shows that Cal Am can claim bonus depreciation in 2011. Finally, Cal Am's explanation of legal uncertainty in bonus depreciation is irrelevant to the Commission's decision to impute bonus depreciation in 2011. That legal uncertainty only goes to the question of how much bonus depreciation to impute. Each of these points will be discussed below.

a) Cal Am's Explanation of Why 2011 Uniquely Qualifies For No Bonus Depreciation Treatment Is Invalid. Cal Am Has Claimed Bonus Depreciation Other Years

Cal Am claims it will not take bonus depreciation in 2011 for several reasons. First, the company will have a "net operating loss" ("NOL") for that year.[63] Second, Cal Am's right to use "net operating loss carry forwards" expires 20 years after the year that

[63] Exhibit CAL AM-42, "Rebuttal Testimony of Charles A. Lenns", Page 9.

net operating losses are incurred,[64] and that 20 year period might not allow Cal Am to fully utilize all of its net operating loss carry forwards.[65] However, as shown below, these concerns have existed in prior years and Cal Am has still claimed bonus depreciation each year in 2010 and intends to do so again in 2012.

As illustrated in the table below, the record shows that Cal Am has claimed bonus depreciation in 2010, and intends to do so again in 2012, but not in 2011. The record also shows that the company has experienced or expects to have NOL's each of these years. Therefore, NOL's in 2011 alone do not provide a rationale for distinguishing 2011 from these other years.

Also as illustrated in the table below, the record shows that Cal Am has claimed bonus depreciation in 2010 and will do so again in 2012. , even though it faced the same risk as the one it claims applies to 2011. In other words, Cal Am's claim that its right to use net operating loss carry forwards would expire within 20 years of the year it incurred its NOL's does not distinguish 2011 from any of these other years in which it claimed bonus depreciation.

Table 2
Cal Am's Trend of Claiming Bonus Depreciation

Year	Cal Am Claimed (Or Intends to Claim) Bonus Depreciation?	Cal Am Experienced (Or Anticipates Experiencing) "Net Operating Losses"?	Cal Am Bore (Or Will Bare) The Risk That "NOL Carry Forwards" Would Expire Within 20 Years?
2010	Yes[66]	Yes[67]	Yes[68]

[64] May 31 Tr. 1130: 27-28 to 1131: 1-8.

[65] May 31 Tr. 1131: 15-22.

[66] Exhibit CAL AM-42, Page 8; Notwithstanding the witness's assertion in hearings (May 31 Tr. 1148: 8-14) that Cal Am has technically not filed its tax return for 2010 yet and thus has not yet claimed the bonus depreciation, the witness's prepared rebuttal testimony, as cited in this footnote, clearly indicates "California American Water elected to take bonus depreciation in 2010."

[67] May 31 Tr. 1133: 11-14.

[68] May 31 Tr. 1131: 11-14.

2011	***No***[69]	Yes[70]	Yes[71]
2012	Yes[72]	Yes[73]	Yes[74]

Therefore, Cal Am provides no reasons that would explain why 2011 is different from other years where it claims or intends to claim bonus depreciation.

b) The Record Shows That Cal Am Can Claim Bonus Depreciation In 2011

As acknowledged by Cal Am in testimony, Cal Am may claim bonus depreciation in 2011 even though it anticipates experiencing a NOL in that year.[75] Cal Am has not met its burden to demonstrate why the Commission should not impute bonus depreciation in 2011. Therefore, the Commission should impute the maximum legal amount of bonus depreciation on Cal Am in 2011 for ratemaking purposes.

c) Nothwithstanding Legal Uncertainty Regarding How Much Bonus Depreciation Applies In 2010, The Commission Still Should Impute 100% Bonus Depreciation In 2011

Cal Am's witness explained at some length during hearings that uncertainty exists within the government about whether a utility who self-constructs assets placed in service after September 8th 2010 can get 100 percent bonus depreciation for all the costs incurred in that plant even though some of the costs were incurred before the law began to grant

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[69] Exhibit CAL AM-42, Page 8.

[70] Exhibit CAL AM-42, Page 9.

[71] May 31 Tr. 1131: 11-14.

[72] Exhibit CAL AM-42, Page 8; May 31 Tr. 1119: 7-13.

[73] Exhibit CAL AM-42, Page 9.

[74] May 31 Tr. 1131: 11-14.

[75] May 31 Tr. 1147: 2-5.

100% bonus depreciation.[76] However, Cal Am's position is beside the point and should not deter the Commission from imputing 100% bonus depreciation to Cal Am in 2011.

Any uncertainty about whether self-constructed utility assets built in 2010 should receive 50% or 100% bonus depreciation has been resolved by guidance from the Internal Revenue Service.[77] Moreover, regardless of the uncertainty about whether assets built in 2010 get 50% or 100% depreciation, self-constructed utility assets placed into service in 2011 are eligible for 100% bonus depreciation. Therefore, the Commission should impute a full 100% bonus depreciation to Cal Am in 2011.

C. Special Requests

1. #4 -CAL AM's Request for Rate of Return on Deferred balances on memo & balancing accounts

Cal Am wants to earn its full, weighted cost of capital return on all deferred balances on California American Water's balance sheet, in excess of the company's short-term debt limit, that currently earns interest at the 90-day commercial paper rate.[78] This request must be denied for several reasons. First, as shown by current Commission precedent and the record, this special request inappropriately seeks to completely change the general practice that allows water utilities to earn only the 90 day commercial paper rate on memorandum and balancing accounts. Second, if the Commission were to grant this special request, it would deny itself future opportunities to evaluate the merits of carrying costs for individual projects. Third, the record shows that this request would create a moral hazard, putting ratepayers in danger by allowing Cal Am the exclusive and unregulated discretion to set its short-term debt limit, thereby determining how much of its deferred regulatory assets earn a full rate of return rather than a mere 90 day commercial paper rate. Finally, Cal Am's alleged safeguards do not protect ratepayers as Cal Am would suggest. Each of these five points will be discussed below.

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[76] May 31 Tr. 1164: 28 to 1169: 19.

[77] May 31 Tr. 1168: 22-28 to 1169: 1-8.

[78] Exhibit CAL AM-15, "Direct Testimony of Jeffrey Linam", Page 3.

a) Cal Am's Special Request Inappropriately Seeks to Completely Change the Commission Recognized Practice That Allows Water Utilities to Earn Only the 90 Day Commercial Paper Rate on Memorandum and Balancing Accounts

The Commission has historically relied upon the general practice of allowing memorandum and balancing accounts to earn the 90 day commercial paper rate. The Commission has applied this practice to Cal Am in numerous proceedings.[79] ven Cal Am's own witness acknowledged that other utilities do not have an ability to earn a return on all deferred balances in excess of their short-term debt limits.[80] Moreover, Standard Practice U-27-W provides that "Memo account balances earn at the 90-day commercial paper rate."[81], and that "Balances in the balancing account earn at the 90-day commercial paper rate."[82] Cal Am has also acknowledged these fundamental tenets of the standard practice.[83] Even American Water Works Inc. has publically acknowledged that regulatory assets do not generally earn a rate of return.[84]

b) Granting Special Request #4 Now Would Deny the Commission the Opportunity to Evaluate the Merits of Carrying Costs for Individual Projects

The Commission saw fit to dedicate an entire decision to determine the issue of the appropriate carrying cost for amounts accrued in the San Clemente Dam

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[79] See D.11-03-035, Pages 27, 33, and Ordering Paragraph 3; Decision 09-07-021, Page 141, and Finding of Fact 59; Decision 09-02-006, Page 28; Decision 08-11-023, Pages 19, 40, 73-4, and 78; Decision 08-06-002, Pages 20, 50, and 55; Decision 07-11-034, Page 26; Decision 06-11-050, Pages 64, 67 and 87, Ordering Paragraph 19, and Special Condition 5.

[80] May 20 Tr. 513: 13-28 and 514: 1-2.

[81] Exhibit DRA 19, "Standard Practice for Processing Rate Offsets and Establishing and Amortizing Memorandum Accounts, Standard Practice U-27-W" at Page 7, Note 28.

[82] Exhibit DRA 19, at Page 8, Note 31.

[83] May 20 Tr. 545: 11-23 and 545: 24-28 and 546: 1-2.

[84] Exhibit DRA-18, Page 98, Note 7.

memorandum account.[85] To grant Cal Am's special request now would deny the Commission future opportunities to evaluate the particular facts of any single project to determine appropriate carrying costs, as it did in D.08-05-036.

c) Granting Cal Am's Request Would Create a Moral Hazard, Putting Ratepayers in Danger By Allowing Cal Am Exclusive and Unregulated Control to Set Its Short-Term Debt Limit

If this special request was authorized, the record shows that Cal Am would have exclusive and unregulated control to set its short-term debt limit as it saw fit. First, Cal Am's witness acknowledged that Cal Am does not need Commission authorization to set its short-term limits.[86] Second, in response to his own counsel on re-direct, Cal Am's witness admitted that Cal Am's own board of directors approves and sets its own short-term debt limit.[87] Finally, as acknowledged by Cal Am in testimony, there would be no unconditional and automatic date certain end to this moral hazard.[88]

The following Table illustrates the moral hazard and danger to ratepayers explained immediately above.

Table 3
Illustration of Moral Hazard Resulting From the Granting of Cal m's Special Request

Interest Rate	Cal Am's Interest on Deferred Regulatory Assets with Currently Set Short-Term Debt of $33 million	Cal Am's Interest on Deferred Regulatory Assets If Cal Am Adjusted Its Short-Term Debt Limits to Zero

[85] Id.

[86] May 20 Tr. 532: 21-24.

[87] May 20 Tr. 553: 14-26.

[88] May 20 Tr. 548: 16-22.

90-Day Commercial Paper Rate[89]	$136,800[90]	$216,000[91]
Average Weighted Cost of Capital[92]	$4,582,800[93]	$7,236,000[94]

The first column shows the annual simple interest Cal Am would collect if it kept its current short-term debt and deferred balances at 2010 levels.[95]

The second column shows the windfall of total annual simple interest Cal Am would collect simply by reducing its short-term debt limit to zero, which it can do without any Commission regulation.[96]

d) Cal Am's Alleged Safeguards Do Not Protect Ratepayers As Cal Am Would Suggest

Cal Am states if its deferred regulatory balances are reduced below the short-term debt limit, the adjustment to average weighted cost of capital goes away.[97] However, as demonstrated earlier, the record shows that Cal Am controls (without any Commission oversight) its short-term debt limit. This means that Cal Am also controls whether

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89 Exhibit CAL AM-43, "Rebuttal Testimony of Jeffrey T. Linam", Page 2 shows that this number is 0.24%.

90 ($90 million - $33 million) X 0.24% = $136,800.

91 ($90 million - $0) X 0.24% = $216,000

92 Exhibit CAL AM-43, Page 2 shows that this number is 8.04%.

93 ($90 million - $33 million) X 8.04% = $4,582,800.

94 ($90 million - $0) X 8.04% = $7,236,000.

95 Exhibit CAL AM-43, Page 2 shows that Cal Am's 2010 short-term debt was $33 million and its deferred balances at the end of 2010 was $90 million.

96 The two columns provide an "apples to apples" comparison in that they both use the same commercial paper rate, same average weighted cost of capital, and same amount of deferred regulatory assets. The only factor that is changing is the short-term debt limit that Cal Am could set.

97 CAL AM-43, Page 8.

deferred regulatory balances drop below the short-term debt limit unless those balances drop to zero. This approach leaves ratepayers exposed to whatever accounting technique will maximize Cal Am's earnings.

Cal Am also states that ratepayers would be protected by an after the fact reasonableness review.[98] his is problematic for several reasons. First, it incorrectly places the burden on ratepayer advocates to show that a particular element is not reasonably earning an average weighted cost of capital, rather than properly leaving the burden with utilities to show that the average weighted cost of capital merits a ratemaking exception in particular instances. Second, it exacerbates the problem that very few deferred regulatory assets, once recorded in memorandum or balancing accounts, are denied.

Finally, Cal Am asserts that after granting this request, it could evaluate and terminate it in the next GRC.[99] However, such a suggestion would leave the Commission in an awkward and untenable position of needing a sufficient record to justify why it should overturn the bad precedent it would have set by granting this request here.

For all of the reasons stated above, the Commission should completely deny Cal Am's request to earn a full, weighted cost of capital return on all deferred balances on California American Water's balance sheet, in excess of the company's short-term debt limit, that currently earns interest at the 90-day commercial paper rate.

e) Granting Cal Am's Request Will Encourage Other Water Utilities to Seek Commission Approval to Earn Higher Returns in an Era of Low Interest Rates

Over the past half-decade interest rates have been at low or extremely low levels. Thus, utilities have been able to finance new plant for lower costs than in previous years. Given this situation, the Commission should send a strong message that the Commission

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[98] CAL AM-43, Page 8.

[99] May 20 Tr. 548: 19-22.

will not look favorably upon utilities' efforts to obtain full ratebase treatment for deferred regulatory assets, instead of the current practice of allowing them to recover the 90 day commercial paper rate. Moreover, given the poor state of California's economy, granting ratebase treatment for deferred assets would inappropriately burden ratepayers. It should be noted that in previous filings utilities have asked for similar treatment for other deferred assets and by-and-large the Commission has denied these requests. If Cal Am's request for such treatment is granted here, it will encourage other utilities to make similar requests in their own proceedings and could further inflate water rates at a time when they are already escalating at a rate higher than the rate of inflation.

f) Denying Cal Am's Request In This Proceeding Should Mean That Similar Cal Am Requests In Other Proceedings Also Be Denied

DRA has already stated its concern in testimony[100] that any duplicative, redundant, or overlapping requests submitted in different but simultaneous filings on this issue creates an untenable situation such that the Commission may inadvertently grant either inconsistent or duplicative relief with attendant that may lead to harm to both ratepayers and the regulatory process. In particular, DRA voiced several concerns. First, allowing such duplicative filings creates the risk that the utility would recover from the same issue twice. Second, the practice of litigating the same issue more than once improperly and unnecessarily burdens the Commission's already strained regulatory resources and review processes. Finally, the practice of asking the Commission to rule more than once in more than one forum puts the Commission at risk of undermining its own authority if two different, or even inconsistent, decisions are rendered on the same issue. In this particular case, DRA is concerned that Cal Am is making a similar request to Special Request 4 in its cost of capital filing--a separate proceeding that is already underway.[101]

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[100] Exhibit DRA 5, pages 132-134.

[101] Exhibit DRA 5, pages 132-134 provides further elaboration of these points.

Therefore, if the Commission denies Special Request 4, DRA respectfully requests that both proceedings be coordinated to ensure that the results on this issue are consistent.

2. #11 -CAL AM's Business Transformation Balancing Account Request

Discussed in GO Section

3. #14 – CAL AM's Request for Recovery of Balances On Memorandum and Balancing Accounts Should Not Be Allowed For the Monterey Water Revenue Adjustment Mechanism (WRAM) Balancing Account and the Monterey Interim Rate True-Up (MIRTU) Memorandum Account

In this application, Cal Am is seeking to recover the outstanding balances in its old Monterey Water Revenue Adjustment Mechanism ("WRAM") balancing account and its Monterey Interim Rate True-Up (MIRTU) memorandum account.[102] DRA strongly opposes this request. DRA recommends that the Commission require Cal Am to follow the Division of Water and Audit's ("DWA") direction on the method of calculating the WRAM balances for 2007, 2008 and January 2009 to May 10, 2009. Furthermore, DRA urges the Commission to direct Cal Am to combine its WRAM balancing account balance and its Monterey Interim Rate True-Up ("MIRTU") memorandum account balance for May 11, 2009 to February 1, 2010, as proposed in DRA's testimony, and only authorize Cal Am to recover $690,259.

Several major errors plague Cal Am's request to recover its outstanding balances in its WRAM balancing account and MIRTU memorandum account. First, Cal Am's computation of its "standard rates" for deriving WRAM and MIRTU account balances is not consistent with applicable Commission precedent. Second, Cal Am inappropriately includes billing adjustments in its determination of the WRAM balance. Third, Cal Am has failed to demonstrate an adequate justification for changing its recorded number of customers to derive its WRAM balance. These errors are discussed in greater detail in

[102] Exhibit CWA-7, Direct Testimony of Sherrene Chew at 27 and 18.

Sections 3, 4, and 5 below. Sections 1 and 2 include a description of what Cal Am should have tracked in its WRAM and MIRTU accounts. Section 6 discusses the issue of the need for an equitable allocation of surcharge recovery across customer classes while Section 7 deals with the truing – up of the January, 2010 MIRTU balance in this GRC, rather than for later recovery.

For the reasons more fully explained below, the Commission should reject Cal Am's request to recover its outstanding balances in its WRAM and MIRTU accounts and should instead adopt DRA's recommendations.

a) Description of the Cumulative WRAM balance prior to May 11, 2009

Cal Am requests that its old Monterey WRAM balancing account be closed and that the Commission authorize the transfer of the outstanding balance to its expense balancing account for recovery.[103] The purpose of the old Monterey WRAM approved in D.96-12-005 was to "track the variation in projected revenue incurred under the experiment, which includes the reduced service charges mentioned above, a lifeline residential rate block, and a rate surcharge for high consumption" in the Monterey District.[104] As explained in its testimony, DRA made recommendations on the cumulative balance in the old Monterey WRAM covering the amounts prior to the interim rates period beginning May 11, 2009.[105] During this time period, only the old WRAM account was operational, not the MIRTU memorandum account.[106]

DRA notes that Cal Am's request to recover the outstanding balance in the old Monterey WRAM includes 2007 and 2008 year balances. DRA already included its WRAM cumulative balance recommendation (up to year-end 2008) in its audit report associated with Cal Am's request to recover the 2008 WRAM balance in Advice Letter

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[103] *Id.* at 27, lines 17-19.

[104] *See D. 96-12-005, Section 7 on Alternate Rate Design and Water Revenue Adjustment Mechanism (WRAM)*

[105] Exhibit DRA-14, Direct Testimony of Josefina Montero at 164.

[106] *Id*. at 150.

735.[107] DWA endorsed DRA's audit finding and rejected Cal Am's Advice Letter 735.[108] Cal Am resubmitted its requests in Advice Letter 838, with a revised balance, but did not follow several of DRA's key audit recommendations.[109] DWA subsequently rejected Advice Letter 838,[110] a decision that Cal Am appealed.[111]

On April 14, 2011, the Administrative Law Judge (ALJ) issued a ruling finding that the 2007 and 2008 WRAM balance is within the scope of this GRC proceeding.[112] Furthermore, the ALJ ruled that this issue will be resolved in A.10-07-007, and therefore Cal Am's pending appeal of DWA's rejection of Advice Letter 838 is moot.[113]

DRA's audit report estimates that Cal Am over-collected $266,062 in 2007 and $229,024 in 2008.[114] In contrast, Cal Am estimated it under-collected its WRAM by ($157,588) in 2007 and ($773,785) in 2008.[115] For the period from January 1, 2009 to May 10, 2009, DRA was unable to calculate the WRAM balance because Cal Am did not provide DRA with the necessary computation or any supporting data.[116] However, it appears that Cal Am used the same method to calculate the WRAM during 2007 and 2008 described in Cal Am's pending appeal of Advice Letter 838.[117] DRA urges the

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[107] Exhibit DRA-14, *Id*. at 151; *see also* Exhibit DRA-14, Appendix 2 and Appendix 4 (note that Advice Letter 735 is a follow-up to Advice Letter 691 included in Appendix 1)

[108] *See* Exhibit DRA-14, Appendix 8.

[109] *See* Exhibit DRA-14, Appendix 9.

[110] *See* Exhibit DRA-14, Appendix 11.

[111] *See* Exhibit DRA-14, Appendix 13.

[112] *See* April 14, 2011 Administrative Law Judge Ruling Granting Outstanding Motions for Party Status and Confirming the Inclusion of the 2007 and 2008 Water Revenue Adjustment Mechanism Issue in this Proceeding at 2, *available at* http://docs.cpuc.ca.gov/EFILE/RULINGS/133571.htm.

[113] *Id.*

[114] Exhibit DRA-14, Appendix 4 at C-82.

[115] *Id*.

[116] Exhibit DRA-14 at 155 (lines 3-5); at 164 (lines 10-11); at 162.

[117] *Id.* at 162 (lines 20-25).

Commission to disallow the balance for the period from January 1, 2009 to May 10, 2009 until Cal Am provides the information and DRA has an opportunity to analyze it.[118]

As discussed below, the Commission should require Cal Am to follow DWA's direction on the method of calculating the old WRAM balance, which is outlined in DRA's audit findings.

b) Description of WRAM-MIRTU Combined Balance from May 11, 2009 to February 1, 2010

From May 11, 2009 to February 1, 2010, both the old Monterey WRAM balancing account and the MIRTU memorandum account were operational.[119] Cal Am's MIRTU memorandum account tracks the difference between interim rates and final rates granted by the Commission.[120] As noted in its testimony, DRA discussed these two accounts together because they are inextricably linked for the reasons discussed below.[121]

In January 2008, Cal Am filed its GRC application, A.08-01-027, for the Monterey District. In the absence of approved rates and in accordance to the Rate Case Plan authorized in D.07-05-062, the Commission approved Cal Am's request for interim rates in Advice Letter 750-B, which became effective on May 11, 2009.[122] In turn, Cal Am used its interim rates to bill its customers for the interim period beginning on May 11, 2009 and ending on February 1, 2010.

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[118] Exhibit DRA-14 at 164 (lines 13-14).

[119] Exhibit DRA-14 at 150.

[120] *See Preliminary Statement (W) in Advice Letter 722..*

[121] Exhibit DRA-14 at 150.

[122] *AL 750 was filed pursuant to Administrative Law Judge (ALJ) Ruling dated December 23, 2008 under A. 08-01-027, 08-01-023 and 08-01-024 which states: " Cal Am is authorized to file an advice letter as provided in Rate Case Plan, II (B)." Per the Ruling, the interim rate increase should be limited to the most recent 12-month ending change in the US Cities CPI-U published by the US Bureau of Labor Statistics. AL 750- A incorporated additional special condition message to each area of the Monterey district which reads as follows: "The rates approved by Advice Letter No. 750 are subject to refund and may be adjusted upward or downward depending on the final rates authorized in A.08-01-027 back to May 11, 2009." AL 750-B supplements AL 750-A at the request of the Division of Water and Audits (DWA) to assign numbers to the tariffs submitted under AL 750-B.*

In July 2009, the Commission issued D.09-07-021 approving new rates arising from A.08-01-027; however, Cal Am did not implement these new rates until February 1, 2010. In Advice Letter 826, concurrent with its request to implement new rates, Cal Am requested permission to true-up the difference between the interim rates (approved in Advice Letter 750-B) and final rates (approved in D.09-07-021) from May 11, 2009 through December 31, 2009, which was tracked in its MIRTU memorandum account.[123] In considering this request, it should be noted that the Commission has already approved Advice Letter 826, that allowed Cal Am to recover an under-collection of ($6,474,490) covering the interim-rate true-up period of May 11, 2009 to December 31, 2009.

During the interim period, the WRAM should have tracked the difference between tiered conservation rate design (or tariff rates) approved in Advice Letter 826 on February 2010 and the standard rate design calculated based on the authorized percentage of fixed costs - 15% - in the service charge approved in D.09-07-021.[124] During the same period, the MIRTU should have tracked the difference between the interim rates actually billed to customers during the interim period and the tiered conservation rate design (or tariff rates) approved in D.09-07-021.[125]

However, DRA's calculation of WRAM and MIRTU balances differ from Cal Am's calculations because of a number of errors in Cal Am's request, as set forth in sections 3, 4 and 5 below. DRA's estimate of the balance in the WRAM balancing account is an under-collection of ($5,064,138) covering the interim period of May 11, 2009 to February 1, 2010, whereas Cal Am's estimate is an under-collection of ($1,185,609).[126] Moreover, DRA's calculation of the balance in the MIRTU memorandum account is an under-collection of ($2,100,611) covering the interim period of May 11, 2009 to February 1, 2010, whereas Cal Am's estimate is an under-collection

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[123] *The purpose of AL 826 was to implement the new rate design for the Monterey District and request recovery of the interim rate true-up memorandum account per D. 09-07-021(see Ordering Paragraph 7).*

[124] Exhibit DRA-14 at 154.

[125] *Id.*

[126] *Id.* at 152.

of ($6,878,324).[127] Taken together, DRA's WRAM-MIRTU estimate is ($7,164,749),[128] while Cal Am's WRAM-MIRTU estimate is ($8,063,933).[129] Thus, after combining these accounts, Cal Am's calculation exceeds DRA's calculation by $899,184.[130]

Given that DWA has already approved Cal Am's request to recover ($6,474,490) in its MIRTU memorandum account in Advice Letter 826, and that Cal Am's combined WRAM-MIRTU balance calculation exceeds DRA's calculation, the Commission should require Cal Am to combine its WRAM-MIRTU balances for the interim period. Based on DRA's calculations of the WRAM-MIRTU balances, and on the three major errors explained below, the Commission should only allow Cal Am to recover $690,259[131] from its customers for the interim period of May 11, 2009 to February 1, 2010.

c) Cal Am's Computation of "Standard Rates" is Incorrect

The first major error in Cal Am's request to recover its calculated outstanding WRAM balance is that its computation of "standard rates" for deriving WRAM and MIRTU account balances is not consistent with Commission precedent. This error is explained below.

(1) Cal Am's use and method of computing "Standard Rates" to derive the MIRTU account balance is inconsistent with Commission precedent

In its MIRTU memorandum account, Cal Am tracks the difference between "standard rate design" under interim revenue requirement and its "standard rate design"

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[127] *Id.* at 151-152.

[128] DRA's estimate = $7,164,749 = $5,064,138 (WRAM) + $2,100,611 (MIRTU)

[129] Cal Am's estimate = $8,063,933 = $1,185,609 (WRAM) + $6,878,324 (MIRTU)

[130] Exhibit DRA-14 at 152 (Table 1).

[131] $690,259 = DRA's estimated WRAM-MIRTU combined balance of under-collection of $7,164,749 minus the under-collection of $6,474,490 DWA already authorized via Advice Letter 826.

under the adopted revenue requirement in D.09-07-021.[132] However, Cal Am has no authority to recover this difference in its MIRTU under any applicable Commission decision. In accordance with the Rate Case Plan adopted in D.07-05-062, while a GRC is pending, a utility can request a memorandum account to track any difference between the interim rates and the final rates.[133] As such, the MIRTU should track the difference between *the interim rates actually billed* to customers during the interim period and the *tier conservation rate design* (or tariff rates) approved in D.09-07-21.[134] Cal Am has disregarded D.09-07-021 and is using its MIRTU memorandum account in an unauthorized manner.

Although DWA already approved the interim rate true-up surcharge covering May 11, 2009 to December 31, 2009 through Advice Letter 826, DRA had to review the computation in the MIRTU memorandum account because the true-up methodology would affect Cal Am's computation of the January 2010 balance that it requests to keep in the memorandum account for later recovery.[135] DRA's review revealed that, in computing the interim rate surcharge, Cal Am used "standard rates" which are different from the actual billed tariffs for the same period covered by the "standard rates."[136] In its rebuttal testimony, Cal Am "asserts that the 'standard rates' are completely different from the conservation rates billed to customers."[137] Cal Am's error appears to be premised on its persistent (but misguided) effort to track the difference in "standard rates" instead of the difference in actual billed tariffs, which directly contravenes the purpose of the MIRTU memorandum account.

In addition, and most troubling, DRA's review revealed that Cal Am continues to derive its "standard rates" by using a percentage of fixed costs recovered in the service

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[132] Exhibit DRA-14 at 154 (lines 15-17).

[133] *See D.07-05-062, Section III C at 18, last sentence..*

[134] *See Preliminary Statement (W) under Advice Letter 722 and Ordering Paragraph 7 of D.09-07-021..*

[135] Exhibit DRA-14 at 158.

[136] Id.

[137] Exhibit CWA-39, Rebuttal Testimony of Sherrene Chew at 14.

charge that is different from what the Commission has approved.[138] For instance, Cal Am calculates its "standard rates" for the interim period by assuming it will recover 41% of fixed costs recovered through the service charge under the interim revenue requirement.[139] However, in D.06-11-050 resolving the 2005 Monterey GRC, the Commission instead authorized Cal Am to recover 37% of its fixed cost in service charge.[140] Cal Am is aware of the adopted 37%, evidenced by the fact that in implementing the 2007 step rate increase under Advice Letter 662, Cal Am included the Cost of Service Allocation computation, which shows that the service charge represents 37% of the total fixed costs (less private fire service revenue and others).[141] DRA found that Cal Am has knowingly used an erroneous 41% of fixed cost recovery in the service charge, which results in a completely different set of tariffs than what the Commission has authorized.

Additionally, Cal Am calculates its "standard rates" for the interim period under the adopted revenue requirement based on 50% recovery of fixed cost in the service charge.[142] However, in D.09-07-021which resolved the 2008 Monterey GRC, the Commission adopted a 15% recovery of fixed cost in the service charge from the approved tariffs.[143] Contrary to Cal Am's assertions in its rebuttal testimony, there is no basis to assume that the standard rates used to calculate the Monterey WRAM should be based on a 50% allocation of fixed cost in the service charge. As explained by DWA, the same Commission-adopted allocation factor of fixed costs in the service charge should be

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[138] Exhibit DRA-14 at 158.

[139] *Id.*

[140] *Exhibit DRA-14, Appendix 5 at C-84 shows the Cost of Service Allocation as a supporting document to Advice Letter 662 (Implementing the 2007 Step Rate Increase). This cost of service was used to derive the rate changes authorized in D. 06-11-050. The fixed costs allowed in service charge ($9,375,000) is 37% of the total fixed costs less private fire service revs and other ($26,167,600): $9,375,000/$25,167,600 = 37%*

[141] *See* Exhibit DRA-14, Appendix 5 at C-84 (Cost of Service Allocation – Supporting Workpapers for Advice Letter 662).

[142] Exhibit DRA-14 at 159.

[143] *See Appendix A of D.09-07-021, Section III B 4, page 4*

applied to both the computation of revenues under the standard rate design and the computation of revenues under the authorized as-billed conservation rate design.[144]

DRA notes that the difference between these two "standard rate design" calculations is what Cal Am has tracked in its MIRTU memorandum account. As explained above, DWA mistakenly approved this calculation method through Advice Letter 826 for a portion of the interim period covering May 11, 2009 through December 31, 2009. However, DRA reiterates that Cal Am is not authorized by any Commission decision to recover this difference in the MIRTU.

(2) Cal Am's method to compute "Standard Rates" to derive the WRAM account balance is inconsistent with Commission precedent

The purpose of the old Monterey WRAM approved in D.96-12-005 is to "track the variation in projected revenue incurred under the experiment, which includes the reduced service charges mentioned above, a lifeline residential rate block, and a rate surcharge for high consumption" in the Monterey District.[145] As explained above, the outstanding balance in the WRAM balancing account includes Cal Am's request to recover 2007 and 2008 WRAM balances in Advice Letters 735 and 838, which are now within the scope of this proceeding. As noted in DWA's rejection of Advice Letters 735 and 838, Cal Am's calculation of its "standard rate design" and WRAM balance is incorrect.[146] In its rejection letter of Cal Am's Advice Letter 735, DWA unambiguously stated as follows:

> "Finally, when calculating the WRAM balances, the 37% factor of fixed costs in the service charge should be applied to the computation of revenues under the standard rate design as

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[144] *See* Exhibit DRA-14, Appendix 11 at C-197.

[145] *See D. 96-12-005, Section 7 on Alternate Rate Design and Water Revenue Adjustment Mechanism (WRAM).*

[146] *See* Exhibit DRA-14, Appendices 8 and 11.

> well as the as-billed conservation rate design authorized in D.06-11-050."[147]

As demonstrated above, the percentage of fixed cost allocated to the service charge to be used for the "standard rate" computation of the WRAM balance should be consistent with the percentage of fixed costs in the service charge approved in D.06-11-050. Therefore, Cal Am should have used a 37% factor of fixed cost in the service charge to compute the revenues under standard rate design and not its 41% factor.

Although Cal Am did not provide its calculations for January 1, 2009 to February 1, 2010, DRA found that it is likely that Cal Am applied the same methodology in this GRC as it used in Advice Letter 838 when calculating the WRAM balance of year 2009 and January 2010, which does not comply with DWA's directions.[148] In accordance with D.09-07-021, the WRAM should have tracked the difference between tiered conservation rate design (or tariff rates) approved in Advice Letter 826 on February 2010 and the standard rate design based on the authorized percentage of fixed costs - 15% - in the service charge approved in D.09-07-021. However, similar to its calculation of "standard rates" in its MIRTU memorandum account, Cal Am calculates its "standard rates" for the WRAM based on 50% recovery of fixed cost in the service charge. By Cal Am using a cost allocation factor higher than the authorized factor adopted in D.09-07-021, the company is attempting to use the WRAM to guarantee additional service charge revenues, which is not the purpose of the WRAM.

d) Cal Am inappropriately includes billing adjustments in its WRAM balance

The second major error in Cal Am's request is its inclusion of billing adjustments in its calculation of the WRAM balance.[149] As it did in calculating its 2007 and 2008 WRAM balance, Cal Am continues to improperly include billing adjustments in its

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[147] Exhibit DRA-14, Appendix 11 at C-197.

[148] Exhibit DRA-14 at 155 (lines 3 to 11).

[149] Exhibit CWA-39 at 16 (lines 7-13).

calculation of the quantity rate portion of the 2009 and 2010 WRAM balance. Cal Am alleges that billing adjustment is a rate adjustment that re-allocates excess usage from the fifth tier to the second tier.[150] However, DRA's audit shows that Cal Am does not always adjust bills to the second tier.[151] Billing adjustments refer to the portion of the customer bills that Cal Am decided to forgive for one reason or another; the most common reason being customer water leakage on the assumption that the customer will take action to remedy or remove the leakage.[152] DRA submits that billing adjustment should not be passed on to all other customers through the quantity rate portion of the WRAM.[153]

First, the Commission has not authorized Cal Am to track billing adjustment in the WRAM. In fact, in a settlement agreement between Cal Am and DRA, it was established that the WRAM is authorized to track differences in rate design only.[154] In accordance with D.00-03-053, which adopted this settlement agreement, **"only differences caused by the design should accrue to the account and…differences caused by variations in consumption are nor appropriately accrued in the account."**[155] No Commission decision or other documentation authorizes Cal Am to track such billing adjustments in the WRAM.[156] Therefore, Cal Am should not use the WRAM to ensure recovery of billing adjustments that are solely based at Cal Am's discretion.

Second, DRA is concerned about the magnitude of these billing adjustments.[157] During its audit of the 2007 and 2008 WRAM balances, DRA found that the 2007

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[150] *Id.* at (lines 27-28).

[151] Exhibit DRA-14 at 163 (lines 22-23).

[152] Exhibit DRA-14, Appendix 4 at C-80.

[153] Josefina Montero/DRA, May 31, 2011 - Transcript at 1088 (lines 3-7 and lines 21-23).

[154] D.00-03-053, Adopting Settlement Agreement between Cal Am and DRA (Special Request 8), Ordering Paragraph 1.

[155] *Appendix D of D.00-03-053, Section 12.08, page 24 (Special Request #8 – Recovery of the WRAM Balancing Account)*

[156] Exhibit DRA-14, Appendix 4 at C-80.

[157] *See* Josefina Montero/DRA, May 31, 2011 - Transcript at 1095-1096.

WRAM balance included $650,000 for billing adjustments.[158] One year later, the 2008 WRAM balance included more that $1,000,000 for the billing adjustments.[159] Neither DRA nor DWA have conducted an audit of Cal Am's billing adjustments. Given that these billing adjustments constitute a significant portion of Cal Am's claimed WRAM balance, the adjustments are entirely done based on the Company's discretion, and these adjustments have not been audited by Commission staff.

Accordingly, the Commission should direct Cal Am to exclude its billing adjustments in determining its WRAM balance. The Commission should also obtain more information regarding how Cal Am is currently making billing adjustments and applying them to its WRAM balance. This will enable the Commission to have a good understanding of how a proposed decision will affect Cal Am's customers.

e) Cal Am has no basis to change its recorded number of customers

The third error in Cal Am's request is its change of recorded number of customers. DRA found that Cal Am's estimates in Advice Letter 838 changed because Cal Am reported a different number for its recorded customers.[160] Specifically, Cal Am increased the number of customers in 2008 to calculate the WRAM balance in Advice Letter 838 compared to Advice Letter 735.[161] Cal Am should not report different numbers for the same years without justification. Cal Am contends that "There is nothing stopping Cal Am from asking for something different than what DWA determined in the September 14, 2009 correspondence."[162] However, DRA found that Cal Am keeps changing its submitted numbers. When Cal Am originally filed to recover the 2008 WRAM under AL 735, it used 30,206 as the number of residential customers. When Cal Am re-filed AL

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[158] *Id; see also* Exhibit DRA-14, Appendix 4 at C-82.

[159] *See* Exhibit DRA-14, Appendix 4 at C-82.

[160] Exhibit DRA-14 163 (lines 23-25).

[161] Exhibit DRA-14 163-164.

[162] See Exhibit DRA-14, Appendix 13 at C-208, 1st paragraph.

838 to recover 2007 and 2008 WRAM, it used a different number for 2008, i.e., 32,786. None of these numbers matches the number of customers in the current GRC application, A.10-07-007 , i.e., 33,840 (Exhibit A, Chapter 3, Table 3-1, page 1 of A.10-07-007) or the reported number in the 2008 Annual Report, i.e., 34,959. DRA's analysis of Advice Letter 838 shows that the financial impact of the additional 2,600 residential customers is an increase of $1.1 Million in the WRAM under collection.[163]

f) Cal Am should make sure that the correct customers pay for the appropriate surcharges

DRA recommends that the Commisssion ensure an equitable allocation of surcharge recovery across customer classes.[164] Because there are differences in the customer classes that pay for the WRAM surcharge compared to the MIRTU surcharge, Cal Am should adjust the customer surcharges to ensure that the monies are recovered from the same customer classes that they would have been if these accounts had not been combined. Specifically, WRAM is recovered from Hidden Hills customers, and is recovered from Private Fire Service and Private Fire Hydrant Service customers. However, MIRTU is recovered from Hidden Hills customers and not from Private Fire Service and Private Fire Hydrant Service customers. Recovery of the WRAM and MIRTU undercollections should be equitably distributed across customer classes.[165]

g) 7. Cal Am should begin to true-up the January, 2010 MIRTU balance in this GRC, rather than for later recovery

Cal Am requested, in the current GRC, that any difference between interim and final rates from January 1, 2010 continue to be tracked in the memorandum account for

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[163] See Exhibit DRA-14, Appendix 12 at C-199, column titled " Cal Am Adjustment: Include additional customers."

[164] Exhibit DRA-14 153 (footnote 8).

[165] Exhibit DRA-14 165

later recovery.[166] For January, 2010, the MIRTU balance is $802,399.[167] DRA, opposes this and instead proposes that Cal Am should begin to true-up the January, 2010 MIRTU balance in this GRC, rather than for later recovery.

DRA's proposal is for the Commission to direct Cal Am to combine the WRAM balancing account balance and the MIRTU memorandum account for May 11, 2009 to February 1, 2010 and only authorize Cal Am to recover $690,259. January, 2010 is part of the interim period and included in DRA's $690,259 proposal and hence should not be treated differently.

4. #18 – Contamination Proceeds

In Special Request #18, Cal Am requested Commission approval for its proposal that all contamination proceeds received (less attorney fees and costs) for contaminated wells in its Sacramento, Los Angeles, and Monterey Districts remain on the books until the Commission issues a final decision in R.09-03-014 ("OIR"). The Commission issued a decision in this rulemaking, D.10-10-018, on October 18, 2010, adopting rules for treatment of contamination proceeds arising from damage awards, and issued a subsequent final decision, D.10-12-058, on December 16, 2010.

Special Request #18 does not remain in dispute since Cal Am has agreed with DRA's recommended treatment of contamination proceeds in the Sacramento District. In Cal Am's rebuttal testimony of David P. Stephenson, Cal Am agrees that the Sacramento contamination proceeds received from Aerojet and the U.S. Air Force should be considered to be a Contribution in Aid of Construction ("CIAC") to offset plant additions made to remediate groundwater contamination.[168] In addition, the ALJ ruled in favor of DRA's motion to strike portions of Dave Stephenson's Rebuttal Testimony concerning

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[166] Exhibit CWA-7, Direct Testimony of Sherrene Chew at 19.

[167] Exhibit DRA-14 158 (lines 8-9).

[168] Exhibit CAL AM-51, Rebuttal Testimony of David P. Stephenson, at 21.

treatment of MTBE contamination proceeds in the Monterey and Los Angeles Districts.[169] Therefore, Special Request #18 is no longer in dispute.

5. #19 – Toro Arsenic Treatment

Discussed in Plant section A.1.

6. #24 – CAL AM's Request to Recover Toro Goodwill

In Special Request #24, Cal Am seeks authorization to recover costs related to the acquisition of the Toro Water Service ("Toro") above the book value of the purchased assets, or goodwill.[170] Cal Am states that, due to the timing of the Toro water system purchase, it did not include the full amount of the Toro Goodwill in its 2008 Monterey County District general rate case.[171] Before the Commission issued D.07-11-034, which approved Cal Am's acquisition of Toro, DRA and Cal Am had previously entered into a Commission-approved settlement agreement that authorized Cal Am to recover $105,403 of Toro Goodwill. While DRA does not oppose Cal Am recovering the agreed-to amount of Toro Goodwill ($105,403), DRA strongly disagrees with Cal Am's request to recover additional goodwill for the reasons discussed below.

a) The Settlement Agreement did not provide for any changes to Toro Goodwill

In this general rate case application, Cal Am is seeking to recover $260,000 of Toro Goodwill, or $155,000 higher than the $105,403 agreed to by DRA and Cal Am in a settlement agreement approved by the Commission.[172] Cal Am argues that "the $105,000 amount of goodwill approved in D.07-11-034 was only an estimate and the ultimate amount of goodwill was not known at the time of the D.07-11-034."[173] Simply put, Cal

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[169] May 26, 2011 Tr., p. 934, lines 20-21; p. 944, lines 11-12.

[170] Exhibit CAL AM-9, Direct Testimony of Jeffrey Dana, at 29.

[171] *Id*. at 29, lines 24-26.

[172] *Id*. at 30.

[173] Exhibit CAL AM-40, Rebuttal Testimony of Jeffrey Dana, at 5.

Am is seeking to modify a settlement agreement already adopted by a Commission decision. DRA opposes Cal Am's attempt to insert a new value for goodwill into an already-adopted settlement agreement.

In D.07-11-034, the Commission authorized Cal Am's acquisition of Toro and approved the settlement agreement between Cal Am and DRA.[174] In that settlement, the Parties agreed that the purchase price of $408,000 represented the fair market value of Toro, which is what Cal Am bid for the system. This bid was accepted by the Federal District Court.[175] This purchase price exceeded the recorded rate base for the Toro water system by $105,403.[176] When utility property is acquired for more than the book value of its assets, the additional payment is referred to as the goodwill. As such, in the settlement agreement approved by the Commission, the Parties agreed that Cal Am could recover $105,403 of goodwill.

DRA submits that nothing in the settlement agreement permits Cal Am to seek upward adjustment to the amount recoverable for the Toro Goodwill. The settlement agreement clearly states that "[t]his Settlement constitutes the Parties' entire Settlement, which cannot be amended or modified without the written and express consent of all the Parties hereto."[177] Absent evidence that the settlement agreement supports changes to the Toro Goodwill amount, Cal Am's apocryphal statement that "the $105,000 amount of goodwill approved in D.07-11-034 was only an estimate" does not constitute grounds for granting Cal Am's request to recover a higher figure for Toro Goodwill.

Cal Am's decision to seek additional goodwill outside of the settlement process undermines the cooperative spirit underlying the initial agreement and represents a breach of good faith. One of the fundamental premises of the settlement process is that

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[174] *See* D.07-11-034, Opinion Approving Sale and Water Conveyance of Toro Water System, Inc. to California American Water, Ordering Paragraph 1 and 2, at 12.

[175] *Id*. at 6; *see also* Attachment A – Settlement Between California American Water Company and the Division of Ratepayer Advocates (Settlement Agreement), para. 2.2 at 4.

[176] *Id*.

[177] *Id*. at 3.

the final agreement reached by the parties is an integrated document that cannot be modified absent the consent of the settling parties. Had DRA known that Cal Am would now seek a higher goodwill figure, DRA might not have agreed to settle the proceeding. As stated above, there is nothing in the settlement agreement that would permit Cal Am to seek more goodwill than what DRA agreed to when it signed the settlement agreement. Therefore, the Commission should deny Cal Am's request for an additional $155,000 of Toro Goodwill.

b) Cal Am assumed the risk of failing to include all the cost of the Toro Acquisition

Cal Am contends that at the time it entered into the settlement agreement with DRA all the accounting factors affecting the computing of Toro Goodwill were not known and certain.[178] Cal Am states that the Goodwill was understated by $155,000 because the transaction cost or acquisition cost was estimated.[179] More specifically, Cal Am asserts "that accounting guidance in effect at the time recognized that the ultimate purchase price would include direct acquisition costs, which are not always known at the time of the acquisition" and "that accounting guidance allows the Company to adjust the acquisition accounting after an acquisition."[180] DRA notes, however, that if Cal Am knew that acquisition cost was an estimate, it could have and should have negotiated this part of the purchase price as part of the settlement agreement.

Furthermore, Cal Am knew that it had to make a best effort to provide an estimate of all costs necessary to purchase the Toro water system, including transactional costs. As stated in the Commission decision, D.07-11-034, adopting the settlement agreement between Cal Am and DRA, "[e]ach Party [to the settlement] expressly assumed the risk of any mistake of law or fact made by such Party or its authorized representative."[181] Cal

[178] Exhibit DRA-13 at 4-3 *citing to* Cal Am's response to DRA data request JRC-001, Q.1(b).

[179] Exhibit CAL AM-40 at 5.

[180] *Id.* at 5, lines 14-17.

[181] D.07-11-034, Attachment A, Settlement Agreement, para. 1.10 at 3.

Am assumed the risk of any misstatement or understatement of the costs, as well as the risk of failing to include any other costs when it settled on the purchase price of $408,000, including only $105,403 of Goodwill. Therefore, the Commission should deny Cal Am's request to recover additional Toro-related Goodwill.

7. #32 –

See Plant: Monterey County District Section A.4. (Monterey Billing System Modification Costs

8. #34 – Cal Am's Request to Amortize Balancing Accounts in Rates on an Annual Basis

In Special Request #34, Cal Am is seeking authorization to amortize all current and proposed balancing accounts balances on an annual basis.[182] This request should be denied for the following reasons. First, the Commission is addressing a large portion of this request in a separate, more recent application, which Cal Am recently filed along with four other Class A water utilities. Second, this request conflicts with Commission precedent and practices applicable to water utilities and inappropriately seeks to change policies that require a broader review and formal industry-wide investigation. These issues are discussed in more detail below.

a) The Commission should deny Special Request # 34 because the Commission is already addressing a large portion of this request in a separate, more recent application which Cal Am recently filed along with four other Class A water utilities

In addition to its request to earn its full, weighted cost of capital return on all of its balancing account balances, Cal Am is seeking Commission approval of its proposal to *annually* amortize the net under-collected balance in its balancing accounts. This request should be denied because the Commission is already addressing a large portion of this request in a separate application. As explained in DRA's Report, two months after Cal

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[182] Exhibit CAL AM-15, Direct Testimony of Jeffrey Linam at 13, lines 4 to 8.

Am filed its general rate case application, A.10-07-007, the Company joined four other Class A water utilities in filing application, A.10-09-017, which seeks Commission approval of a proposed modification of the mechanism Cal Am is using to amortize its conservation-related balancing accounts, the Water Revenue Adjustment Mechanism and the Modified Cost Balancing Accounts ("WRAM/MCBA").[183] The under-collection in Cal Am's WRAM/MCBA accounts represents approximately 86% of the total under-collected balance in Cal Am's balancing accounts,[184] meaning that a significant portion of this balance is being addressed in the more recently filed application. As such, Special Request #34 overlaps with the separate application pending before the Commission.

Moreover, Cal Am's Special Request #34 appears to be inconsistent with and not as fully developed as its more recently filed application. In A.10-09-017, Cal Am and four other Class A water utilities submitted nine requests, including proposed modifications to the amortization periods and modification to the triggers that would allow the amortizations to take effect.[185] For example, one specific proposal is to recover, over an 18-month period, WRAM/MCBA under-collections when the balance is in excess of 5% of a utility's annual authorized revenue requirement.[186] In contrast, in the instant proceeding, Cal Am has presented a more radical change in its existing practices so that it would be able to amortize "all current and proposed balancing accounts balances" in rates on an *annual* basis and "requests that the change be made on a prospective basis."[187] Unlike Cal Am's WRAM/MCBA proposals, Special Request #34 does not specify over what period Cal Am would be allowed to amortize or recover these balances. In addition, it is not clear whether Special Request #34 seeks to remove all

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[183] *See* A.10-09-017, Application of California-American Water Company, California Water Service Company, Golden State Water Company, Park Water Company, and Apple Valley Ranchos Water Company.

[184] Exhibit DRA-5 at 129.

[185] *See* A.10-09-017 at i-iv.

[186] *Id*. at 5.

[187] Exhibit CAL AM-15 at 11, lines 16 to 18.

Commission adopted triggers that would allow Cal Am to amortize under-collected balances in its balancing accounts consistent with Standard Practice U-27-W. DRA also notes that Cal Am does not justify the need to annually amortize non-WRAM/MCBA balancing accounts in its GRC application or its WRAM/MCBA filing. Based on the above, Cal Am's Special Request #34 does not provide sufficient information upon which the Commission could grant relief. Furthermore, this is a broad change in Commission water policy that should be addressed through a formal rulemaking or investigation.

In its rebuttal testimony, Cal Am states that it "is willing to accept the position of parties and DRA to limit this Special Request to just WRAM/MCBA accounts."[188] However, Cal Am continues to request that the amortization of WRAM/MCBA balances be resolved in this proceeding.[189] DRA submits that Cal Am's most recent application, A.10-09-017, is the proper proceeding in which to address the amortization of WRAM/MCBA balances. In that proceeding, Cal Am submitted additional data for review on the possible causes of the large WRAM/MCBA balance under-collections, including new material with different options for dealing with the balances.[190] Cal Am did not submit this information in its GRC application. The Commission cannot grant Cal Am's request based on information that is not in evidence in this proceeding. Given the very limited record in this proceeding, Cal Am has not met its burden of proof that Special Request #34 is necessary.

Cal Am claims its request should be timely resolved in Cal Am's GRC application to address the financial effect of its under-collected balancing accounts.[191] However, the Assigned Commissioner and Administrative Law Judge have already issued a Scoping

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[188] Exhibit CAL AM-43, Rebuttal Testimony of Jeffrey Linam at 12-13.

[189] *Id*. at 13.

[190] *See* Assigned Commissioner and Administrative Law Judge's Ruling and Scoping Memo (A.10-09-017), June 8, 2011, p. 3-4, *available at* http://docs.cpuc.ca.gov/EFILE/RULC/136757.htm (Scoping Memo, A.10-09-017).

[191] Exhibit CAL AM-43 at 11-13.

Memo in A.10-09-017 granting an expedited schedule to address the amortization of Cal Am's largest under-collected balancing account balance – its 2010 and 2011 Monterey District WRAM/MCBA balances.[192] In addition, the Scoping Memo sets forth a procedural scheduled to address the WRAM/MCBA balances incurred to date and estimated for 2011 in all other Cal Am districts.[193] The Scoping Memo indicates that a final Commission decision resolving A.10-09-017 will be issued on December 2011 – which is the same month a final Commission decision will be issued on Cal Am's GRC application, A.10-07-007.[194] Therefore, Cal Am's Special Request #34 should be denied given that the Commission is already addressing the substance of this request in A.10-09-017 and will be issuing a decision in the same time frame as its decision on Cal Am's GRC application.

b) The Commission should deny Special Request # 34 because it conflicts with Commission precedent and practices applicable to water utilities

DRA also notes that Cal Am's Special Request #34 inappropriately seeks to change Commission precedent and recognized practices that require a broader review and formal industry-wide investigation. In Order Instituting Investigation, R.01-12-009, the Commission evaluated the practices and policies for processing the recovery or refund of balancing account balances for all Class A water utilities.[195] After a lengthy review of the background and history of the balancing accounts, the Commission issued D.03-06-072, which adopted triggers that would allow water utilities to request recovery of a net under-collection in their balancing accounts by amortizing the under-collection and

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[192] Scoping Memo, A.10-09-017, at 13-14.

[193] *Id*.

[194] *Id*. at 14.

[195] *See* D.03-06-072, Final Decision Revising the Procedures for Recovery of Balancing-Type Memorandum Accounts Existing on or After November 29, 2001, June 19, 2003.

applying a surcharge to the quantity rates.[196] In addition, the Commission subsequently issued a decision, D.06-04-037, setting forth when Class A water utilities must report the status of their balancing accounts and when and over what period they can recover under-collections in their balancing accounts.[197] The balancing account amortization rules adopted in these two Commission decisions are reflected in the Division of Water and Audits Division's Standard Practice U-27-W, as follows:

- Balances less than 2%[198] should not be amortized unless in a utility's general rate case subject to reasonableness review;
- Balances between 2% and 5% should be amortize over a 12-month period
- Balances between 5% and 10% should be amortize over a 24-month period
- Balances above 10% should be amortize over 36 month period[199]

As demonstrated by the rules the Commission has adopted, Cal Am's request to *annually* amortize all of its balancing accounts, including non-WRAM/MCBA accounts, regardless of the net under-collection, is in direct conflict with Commission precedent and the Water Division's Standard Practice U-27-W. DRA submits that Cal Am's request to deviate from Commission precedent and practice would have implications stretching across the water industry and would require significant reconciliation with standing Commission decisions and adopted settlement agreements. As discussed above, since the majority of the relief Cal Am requests in Special Request #34 is also requested in a multi-party application, the proper proceeding for resolving the amortization

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[196] D.03-06-072, Appendix A at 3.

[197] D.06-04-037 at 10 (Ordering Paragraph 3).

[198] In Cal Am's WRAM/MCBA decisions, the Commission adopted an advice letter process to recover or refund WRAM/MCBA balances that exceed 2.5% of the district's authorized revenue requirement.

[199] *See* D.03-06-072, Appendix A at 3; D.06-04-037 at 10; and Standard Practice U-27-W at 9 (para. 39) and 28.

schedule for balancing accounts is in the multi-party application simultaneously pending before the Commission.

Finally, Cal Am's concern that the current amortization mechanism may not comply with financial standards does not justify any changes to the amortization of existing balancing account balances at this time. In its direct testimony, Cal Am states that the current amortization "mechanism may conflict with Financial Accounting Standards Board (FASB) Emerging Issues Task Force (EITF) Issue Paper 92-07 which requires such mechanisms to collect revenue within 24 months of the end of the period for which revenue is recognized."[200] In A.10-09-017, Cal Am and other water utilities requested an interim ALJ ruling to allow an immediate interim surcharge to recover 2008, 2009, and 2010 WRAM/MCBA amounts that will not be otherwise recovered consistent with EITF 92-7.[201] However, despite Cal Am's concerns, the Scoping Memo did not find the need for an immediate interim surcharge because there is no evidence that Cal Am would need to restate its 2010 financial statements.[202] As such, Cal Am's concern regarding compliance with financial standards has already been addressed and does not support Special Request #34. Furthermore, EITF 92-07 is a only applicable to balancing accounts that track utility revenues, not balancing accounts that track costs.

For all the reasons discussed above, Cal Am's request to amortize all current and proposed balancing accounts balances in rates on an annual basis should be denied and any modifications to the amortization of WRAM/MCBA balances on a going forward basis should be made in A.10-09-017 -- Cal Am's WRAM/MCBA account application.

D. General Office

1. Adjustment #1 – Labor and labor-related expense

To justify any request for additional earnings the Commission has stated unequivocally that

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[200] Exhibit CAL AM-15 at 13-14.

[201] Scoping Memo, A.10-09-017, at 11.

[202] *Id.* at 12.

> "The burden rests heavily upon a utility to prove with clear and convincing evidence, that it is entitled to the requested rate relief and not upon the Commission, its staff, or any interested party to prove the contrary."[203]

Cal Am has not met its burden to justify its requested amount of labor and labor-related expenses for several reasons. First, Cal Am's methodology for calculating labor and labor-related expenses does not follow Commission precedent. Second, in spite of its inflated request, Cal Am has failed to meet its burden of demonstrating why it has consistently high vacancy rates among its staff and it has a declining trend in Service Company employee numbers.

Because of Cal Am's failure to meet its burden of justifying its request, DRA recommends that the Commission authorize labor and labor-related expenses by projecting the recent declining trend of general office employees into the test and escalation years. Alternatively, and at a maximum, the Commission should only authorize annually escalated labor and labor-related expenses based upon the headcount of the Service Company's actual employees at year end 2010.

Finally, DRA recommends that the Commission calculate Cal Corp labor expenses based upon the amount recorded in 2009. This is because Cal Am has also failed to meet its burden to justify its inflated CalCorp labor expenses, which are requested separately from and in addition to other general office expenses.[204]

a) Cal Am's Methods for Calculating Labor and Labor-Related Expenses Do Not Follow Commission Precedent

Cal Am has proposed several methods for calculating labor and labor related expense that contradict recent Commission requirements. Cal Am proposed to calculate General Office labor and labor-related expenses using budgeted (authorized) positions

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[203] D.09-07-021, Page 65.

[204] See CAL AM Updated Exhibit A, "California-American Water Update to General Rate Case Application, Sacramento-Service Company Attachment 1, Volume 2 of 2", Exhibit A-CC, Chapter 2, Table 3, Pages 1 of 2 and 2 of 2.

rather than actual employees.[205] However, in a recent Cal Am general rate case, the Commission explicitly required calculation of employees for the test year based upon actual employees rather than authorized (budgeted) employee positions.[206] DRA has performed its analysis consistent with this Commission guidance.

b) Cal Am Has Failed to Offer a Valid Justification for its Consistently High Vacancy Rates and its Declining Trend in Service Company Employee Numbers

In a recent Cal Am General Rate Case, the Commission agreed with DRA's approach of calculating American Water Service Company's test year employee count based upon an actual employee count from the base year.[207] While DRA continues to favor this general approach, DRA proposes a slight modification in this case to recognize that Cal Am and its Service Company have experienced a declining trend of actual general office employee headcount and Cal Am has experienced consistently high vacancy rates.

(1) Ratepayers Should Not Be Required to Fund Cal Am's Consistently High Vacancy Rates

Cal Am has requested that the Commission ignore its recent history of having an ongoing vacancy rates of between 8-10 percent, suggesting that a recent transfer by some employees out of the Service Company to state subsidiaries happened between 2008 and 2010.[208] However, Cal Am has provided no evidence that employee transfers are the cause of the Service Company's ongoing vacancy rate that has averaged 9% in 2009 and 2010.[209] In the last rate case this same issue was litigated. In that proceeding Cal Am

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[205] Exhibit DRA-31, Page 2-2.

[206] D.09-07-021, Pages 97 and 100.

[207] D.09-07-021, Pages 97 and 100.

[208] Exhibit CAL AM-55, Pages 6-8.

[209] Exhibit DRA-31C, Page 3-1.

sought Commission approval to fund unfilled positions amounting to approximately 9% of total authorized Service Company staffing as of May 31, 2008. Instead the Commission held that actual employee numbers should be used to calculate test year labor expense.[210] he pattern evident from the prior and current rate cases make clear that substantial Service Company vacancies is a perennial issue, and not the temporary result of machinations in organizational structure or subsidiary reporting relationships. Moreover, Cal Am did not provide explicit numbers delineating the number of employees who have actually left the company. In short, Cal Am cannot justify that it needs all of its budgeted positions when almost 10% of those budgeted positions remain consistently vacant. Consistent with prior Commission decisions, Cal Am ratepayers should not be required to fund unfilled positions.[211]

(2) Trend Showing Decline In Service Company Employees

Cal Am also asserts that the decline in the Service Company's labor force is misleading and is derived from irrelevant data.[212] On the contrary, the record shows a declining trend in the total number of general office employees from 2008 to 2010, as shown below. This is the basis for DRA's first suggestion, to calculate labor and labor related expenses by projecting this declining trend into the test and escalation years. Below is a table showing the declining trend in general office employees.

[210] D.09-07-021, Page 97. The Commission noted that Service Company staffing levels would have to be increased by 9 percent (the vacancy rate) from the actual end-of-May, 2008 (actual) employee levels recommended by DRA in order to meet its test year projections.

[211] *See* D.10-11-035, and D.10-12-059

[212] Exhibit CAL AM-55, Page 6.

Table 4
Trend Showing Decline in Total Number of General Office Employees[213]

Year	December, 2008	December, 2009	December, 2010
Total Actual General Office Employees	1,697	1,624	1,584

c) In Authorizing Labor and Labor-Related Expenses, The Commission Should Project Such Expenses By Applying The Recent Declining Trend of General Office Employees

Cal Am's general office has experienced an average decline of 57 employees in each of the past two years.[214] The chart below then shows what this trend looks like projected out to 2011, 2012 and 2013 at a continued decline of 57 employees per year.

Table 5
Projected Decline in Total Number of General Office Employees

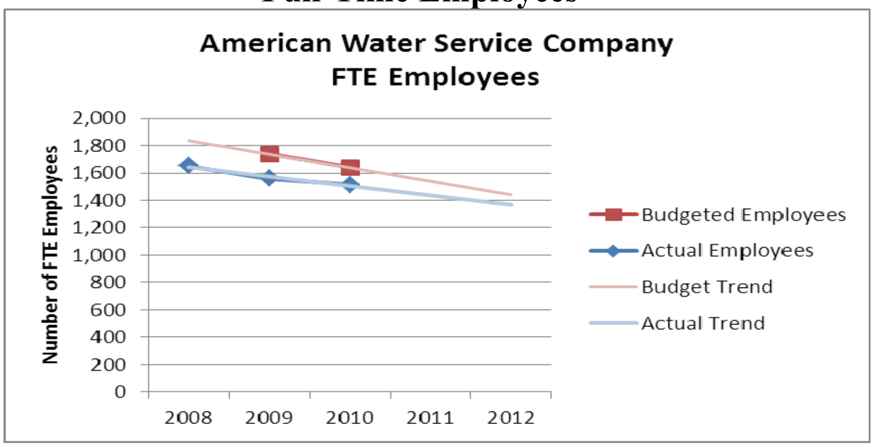
Year	December, 2010	December, 2011	December, 2012	December, 2013
Projected Actual General Office Employees	1,584	1,527	1,470	1,413

[213] Exhibit DRA-31C, Page 2-3.

[214] 1,697 – 1,624 = 73; 1,624 – 1,584 = 40; (73 + 40)/2 = 57.

This trend is supported by the analysis provided in the record by DRA's independent auditor as well. As they point out, "given the downward trend in AWSC's labor force, it is more likely that Overland's recommended staffing overstates the force level likely to be employed in AWSC in 2012 and 2013."[215] The chart below, identified by the independent auditor illustrates the declining trend in American Water Service Company full-time employees.

Table 6
Trend Showing Decline In American Water Service Company Full-Time Employees[216]



d) Alternatively, At A Maximum, The Commission Should Only Authorize Annually Escalated Labor and Labor-Related Expenses Based Upon the Service Company's Actual Employees At Year End 2010

Cal Am calculated requested General Office labor and labor-related expenses using budgeted (authorized) positions rather than actual employees.[217] However, the Commission has agreed with DRA's approach in a recent Cal Am General Rate Case of using labor costs of actual employee count based upon a single day from the base year as

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[215] Exhibit DRA-31C, Page 2-3.

[216] Exhibit DRA-31C, Page 2-3.

[217] Exhibit DRA-31C, Page 2-2.

the best predictor of Cal Am's actual employee count during the test year, and consequently, the total labor cost. Consistent with Commission requirements in that GRC,[218] DRA's consultant has counted actual employees on December 31st, 2010 to predict Cal Am's actual employee count for 2011, and the consequent total labor cost.[219]

If the Commission chose to apply this requirement again, and used the escalation factors for labor and labor-related expenses that Overland has recommended, the following analysis would apply to determine labor and labor related expenses for 2011, 2012, and 2013.

In December 2010, Cal Am had 1,584 total general office employees.[220] Based upon this, Overland recommended reducing Cal Am's requested 2010 labor and labor related expenses by $1,223,635,[221] from $7,016,176 to $5,792,541.[222] The table below takes these numbers, and applies Overland's recommended escalation factors for labor and labor related expenses, in order to show recommended Overland's expenses for 2011, 2012, and 2013.

Table 7
Labor and Labor Related Expenses Using Employee Count Method Required by D.09-07-021

Year	Escalation Factor	Cal Am's Requested of Labor and Labor Related Expenses (After Escalation Factor Applied)	D.09-07-021 Required Adjustment (After Escalation Factor Applied)	Overall Total for Labor and Labor Related Expenses As Required by D.09-07-021

[218] D.09-07-021, Pages 97 and 100.

[219] Exhibit DRA-31, Pages 5-5 and 5-7. Per Exhibit DRA-31, Page 5-8 fn 128, exceptions include two new positions added to Cal Corp in 2011 based on the fact that employment offers had been extended. Also, Overland believes the downward trend in AWSC's call center force levels, which are based on operational changes that are improving productivity, should be recognized going forward through the forecast period.

[220] Exhibit DRA 31C, Page 5-9, Table 5-4.

[221] Exhibit DRA 31C, Page 2-1, Table 2-1, Adjustment #1: Labor and Labor-Related Expense.

[222] Exhibit CAL AM-55, "Rebuttal Testimony of Doneen Hobbs on General Office Issues", Page 5.

2010	Base Year[223]	$7,016,176[224]	$1,223,635[225]	$5,792,541[226]
2011	3.10%[227]	$7,233,677[228]	$1,261,568[229]	$5,972,109[230]
2012	3.12%[231]	$7,459,368[232]	$1,300,929[233]	$6,158,439[234]
2013	3.04%[235]	$7,686,133[236]	$1,340,477[237]	$6,345,656[238]

e) The Commission Should Allow Cal Corp Labor Expenses Only Based Upon The Amount Recorded In 2009

(1) Labor Expenses Only Based Upon The Amount Recorded In 2009

Cal Am claims that customers realize a direct financial benefit with the elimination of positions because they pay lower rates as the result of labor savings.[239] This alleged benefit does not provide a rationale for submitting an inaccurate estimate of

[223] This is the year Overland used to do its employee count based upon the precedent set by D.09-07-021, Pages 97 and 100.

[224] Exhibit CAL AM-55, Page 5.

[225] Exhibit DRA-31C, Page 2-4, Table 2-3.

[226] Exhibit CAL AM-55, Page 5.

[227] Exhibit DRA-31C, Page 2-4, Table 2-3.

[228] $7,016,176 X 3.10% = $7,233,677.

[229] Exhibit DRA-31C, Page 2-4, Table 2-3; $1,223,635 X 3.10% = $1,261,568.

[230] $7,233,677 - $1,261,568 = $5,972,109.

[231] Exhibit DRA-31C, Page 2-4, Table 2-3.

[232] $7,233,677 X 3.12% = $7,459,368.

[233] Exhibit DRA-31C, Page 2-4, Table 2-3; $1,261,568 X 3.12% = $1,300,929.

[234] $7,459,368 - $1,300,929 = $6,158,439.

[235] Exhibit DRA 31-C, Page 2-4, Table 2-3.

[236] $7,459,368 X 3.04% = $7,686,133.

[237] Exhibit DRA-31C, Page 2-4, Table 2-3; $1,300,929 X 3.04% = $1,340,477.

[238] $7,686,133 -$1,340,477 = $6,345,656.

[239] Exhibit CAL AM-9, “Direct Testimony of Jeffrey M. Dana”, Page 13.

actual employee numbers for Cal Corp labor expenses for several reasons. First, Cal Am continues to request exponential increases in labor expenses per customer.[240] Second, Commission precedent would suggest calculating Cal Corp labor expenses based upon expenses actually incurred in the base year. This section shows DRA's recommendation for Cal Corp labor expenses in the test and escalation years. Finally, Cal Am has not adequately demonstrated the actual need for the new Cal Corp positions. Each of these points will be discussed in turn.

(2) Ninefold Increases in Labor Expenses Per Customer

The chart below shows Cal Am's recorded and projected increases in Cal Corp labor expenses while keeping approximately the same amount of customers each year.

Table 8
Exponential Increase in Cal Corp Labor Expense Per Customer

Year[241]	Labor Expenses[242]	Number of Customers[243]	Labor Expense Per Customer[244]
2005	$842,000	169,720	$4.96
2006	$488,900	170,694	$2.86

[240] CAL AM Updated Exhibit A, "California-American Water Update to General Rate Case Application, Sacramento-Service Company Attachment 1, Volume 2 of 2", Exhibit A-CC, Chapter 2, Table 3, Pages 1 of 2 and 2 of 2.

[241] CAL AM Updated Exhibit A, "California-American Water Update to General Rate Case Application, Sacramento-Service Company Attachment 1, Volume 2 of 2", Exhibit A-CC, Chapter 2, Table 3, Pages 1 of 2 and 2 of 2. Years 2005-2009 are recorded, while years 2010-2013 are estimated.

[242] CAL AM Updated Exhibit A, "California-American Water Update to General Rate Case Application, Sacramento-Service Company Attachment 1, Volume 2 of 2", Exhibit A-CC, Chapter 2, Table 3, Pages 1 of 2 and 2 of 2. Years 2005-2009 are recorded, while years 2010-2013 are estimated.

[243] CAL AM Updated Exhibit A, "California-American Water Update to General Rate Case Application, Sacramento-Service Company Attachment 1, Volume 2 of 2", Exhibit A-CC, Chapter 2, Table 3, Pages 1 of 2 and 2 of 2. Years 2005-2009 are recorded, while years 2010-2013 are estimated.

[244] This number was derived by taking the total labor expenses for each year and dividing that by the number of customers shown for that year.

2007	$2,157,700	171,343	$12.60
2008	$4,201,600	171,592	$24.49
2009	$5,143,300	171,359	$30.01
2010	$7,655,900	171,913	$44.53
2011	$8,301,400	172,173	$48.22
2012	$8,401,100	172,406	$48.73
2013	$8,649,600	172,607	$50.11

As demonstrated in the table above, Cal Am's recorded labor expense per customer increased by more than six times from 2005 to 2009. Moreover, Cal Am's estimates its labor expense per customer in test year 2011 to be approximately nine times its expense recorded in 2005. By 2013, Cal Am estimates its labor expense being more than 10 times its labor expense in 2005. Meanwhile, Cal Am's total number of customers only increased by 1,639 from 2005 to 2009, and is only estimated to increase an additional 694 customers by 2013, or less than half a percent over three years.

Cal Am provides no justification for this overall exponential increase in labor expenses per customer.

(3) Commission Precedent Would Support Calculating Cal Corp labor Expenses Based Upon Expenses Actually Incurred In The Base Year

In a recent general rate case, the Commission required calculating labor expenses for the test year based upon actual employee head count for the baseline year.[245] CalCorp's employee headcount was 63,[246] and the recorded labor expense in 2009 was

[245] D.09-07-021, Pages 97 and 100.

[246] Exhibit DRA 31C, Page 5-9, Table 5-4.

$5,143,300.[247] The table below applies labor related expense escalation factors recommended by DRA's consultant, Overland, to actual 2009 CalCorp labor expenses in order to recommend Cal Corp labor related expenses for 2010, 2011, 2012, and 2013.

Table 9

DRA's Recommended CalCorp Labor Expenses for Test and Escalation Years

Year	Escalation[248] Factor	Cal Corp Labor Expenses
2009	N/A	$5,143,300[249]
2010	3.94%	$5,345,946[250]
2011	3.10%	$5,511,670[251]
2012	3.12%	$5,683,634[252]
2013	3.04%	$5,856,416[253]

f) Cal Am Has Not Adequately Demonstrated The Actual Need of The New Cal Corp Positions

In light of the difficult economic situations experienced by many ratepayers, Cal Am's failure to meet its ongoing burden to demonstrate the actual need for its newly proposed CalCorp positions is particularly troubling. Only in the case of one position

247 CAL AM Updated Exhibit A, "California-American Water Update to General Rate Case Application, Sacramento-Service Company Attachment 1, Volume 2 of 2", Exhibit A-CC, Chapter 2, Table 3, Pages 1 of 2 and 2 of 2. Cal Am's most recent recorded data is 2009, so this is the most recent baseline DRA can use for purposes of analysis.

248 Exhibit DRA 31C, Page 2-4, Table 2-3. Uses escalation factors recommended for American Water Service Company.

249 CAL AM Updated Exhibit A, "California-American Water Update to General Rate Case Application, Sacramento-Service Company Attachment 1, Volume 2 of 2", Exhibit A-CC, Chapter 2, Table 3, Pages 1 of 2 and 2 of 2. Shows recorded Cal Corp labor costs for 2009.

250 $5,345,946 + 3.94% = $5,345,946.

251 $5,345,946 + 3.10% = $5,511,670.

252 $5,511,670 + 3.12% = $5,683,634.

253 $5,683,634 + 3.04% = $5,856,416.

does Cal Am provide a cursory explanation of its need, which was insufficient for proper evaluation.[254] None of the other Cal Corp positions have actual needs for the position identified.[255] Moreover, it is unclear from Cal Am's discussion of these positions whether they require full-time employees.[256] Next, in spite of the fact that the Commission disallowed five engineering positions requested by CalCorp in the last rate case, Cal Am opted to fill three of them at this time.[257] Finally, Cal Am has created a new "Diverse Procurement Manager" to focus the company on providing opportunities for diverse vendors to bid on and supply necessary goods and services.[258] The company has effectively functioned without such a position until this time. Moreover, DRA believes that Cal Am should be required to show it cannot provide such a function on a shared basis at the Service Company level before requesting customer funding for a full-time employee.

For the reasons stated above, the Commission should authorize labor and labor-related expenses for general office by projecting the recent declining trend of general office employees into the test and escalation years. Alternatively, and at a maximum, the Commission should only authorize annually escalated labor and labor-related expenses based upon the Service Company's actual employees at year end 2010. Finally, the Commission should calculate Cal Corp labor expenses based upon the amount recorded in the test year of 2009.

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[254] Exhibit CAL AM-9, Page 11 reference to Water Treatment Operator noting "This position is necessary for the new arsenic and other treatment plants."

[255] Exhibit CAL AM-9, Pages 6-12.

[256] Exhibit CAL AM-9, Pages 6-12.

[257] Exhibit CAL AM-9, Page 10.

[258] Exhibit CAL AM-9, Page 12.

2. Adjustment #2 – Pension Expense

a) For California Employee Pension Expense Cal Am Requests More Than Twice The Amount It Was Last Authorized

Cal Am's requested defined benefit pension expense includes expense for all Cal Am employees (Cal Corp and the districts), as well as expense allocated from American Water Service Company. The table below compares authorized and requested pension expense for California and the service company.

Table 10

California Employee Pension Expense[259]-Comparison of Last Authorized Total Expense with Amount Requested in 2012.

Total Amount Last Authorized (2008-2010)	$1,672,300
Requested in 2012	$4,386,600

Table 11

California Allocation of National Service Company Pension Expense[260]

Last Authorized	Not Determined or Documented by Cal Am
2009 Actual	$929,523
2012 Requested	$835,114

Cal Am's requests for California and service company employee pension expense are based on two different accounting approaches. For Cal Am employees, Cal Am's request is based on what it asserts to be a calculation of projected plan contributions prepared in April, 2010. For allocations of Service Company employee pensions, it is

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259 Cal Am Exhibit A-CC, Ch. 3, Table 1 – 100 day update.

260 Exhibit DRA 31 - Regulatory Audit of California American Water Company's General Office Expense (Public Version), Page 6-6, Table 6-1.

based on expense calculated using Generally Accepted Accounting Principles (GAAP); specifically, Financial Accounting Standard 87. Cal Am's request contains expenses calculated using two different methods even though all of the employees involved (both California and Service Company) are part of the same defined benefit pension plan. Not surprisingly, Cal Am's use of two different methods leads to two significantly different results. The 2012 expense requested for California employees is more than double the amount currently authorized for rate recovery, while the 2012 expense requested for pensions allocated from the Service Company is lower than the amount allocated in 2009.

b) Cal Am Has Not Provided Sufficient Justification For Its Pension Requests

In the prior rate case the Commission noted the following:

> "Confronted with "seemingly endless" increases in administrative costs, the Commission has adopted the rate of customer growth as a guideline for evaluating proposed increases in Administrative and General Costs such as those proposed by Cal-Am in its General Office application. Although not an absolute cap, proposed increases that exceed the rate of customer growth must meet a "heavy burden" to demonstrate reasonableness."[261]

Despite a request that more than doubles the currently authorized pension for California employees, and despite the lack of anything but a token increase in customers, Cal Am's application is remarkably devoid of an explanation or justification for the increase. Following are the <u>complete</u> explanations for the increase in California pension expense contained in Cal Am's rate filing and direct testimony:

> "Due to Investment Performance of Pension Assets."[262]

> "[T]here are a number of costs that have risen much greater than inflation, costs over which the company has little

[261] D. 09-07-021, p.94.

[262] CAL AM Exhibit A-CC, Chapter 1, Table 2.

> control, such as group insurance, pension and other employee expenses."[263]

> "Pension contributions have . . . risen dramatically due to the decline in the value of the plan assets which was driven by the decline of the stock market in 2008 and early 2009."[264]

That is the extent of Cal Am's prima facie case. Cal Am fails to mention the Pension Protection Act (PPA) and its impact on projected pension contributions; that its projected GAAP pension expense is decreasing while required PPA contributions are supposed to be increasing; Cal Am has offered no explanation for the phenomenon that forecasted PPA contributions change significantly every time they are calculated; or a rationale for its forecast that PPA contributions will spike in 2012 and decline thereafter. In fact, when asked, Cal Am's designated expert witness on pension expense (David Stephenson), was not even familiar with the Pension Protection Act, and therefore knew nothing about how PPA projections affected Cal Am's requested pension increases.

> "Q. Mr. Stephenson, are you aware of the Pension Protection Act? Are you familiar with that?
>
> A. No, I'm not."[265]

c) Without Explanation, Pension Calculations For California Employees Increase While Those For Service Company Employees Decrease

Similarly, Cal Am provides no explanation as to why it is reasonable to apply increasing calculations of pension expense for California employees when its own Service Company employees are projected to have annual decreases in pension

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[263] Exhibit CAL AM 27, pages 106-107.

[264] Exhibit CAL AM 9, "Direct Testimony of Jeffrey Dana", page 18.

[265] May 25 Tr. 832: 12-15.

expense.[266] Given such a thin and inconsistent record, Cal Am has failed to meet the evidentiary burden identified above that applies to Cal Am.

In its testimony, DRA's independent auditor recommended that Cal Am adopt American Water's Generally Accepted Accounting Principles ("GAAP") pension expense, which is expected to decline from $81.1 million in 2009, to $54.3 million in 2012, and to $34.4 million in 2015.[267] Despite a forecast of GAAP pension expense that is about a third less in the test year than it was in 2009, Cal Am requests a large increase its pension expense for its California employees, but offers no explanation for this increase. DRA's discovery did uncover the underlying rationale for Cal Am's request and an explanation of the disparity between its request and its forecasted GAAP expense. Cal Am's application and rebuttal testimony do not have this information.

In rebuttal testimony, Cal Am cites authority for its requested pension expense as Commission Decision 10-06-038, which states:

> "California American Water Company is authorized to file a Tier 1 advice letter to establish a balancing account for each district to track and recover variations in pension expenses. The balancing accounts shall be used to track the difference between the level of expenses authorized in rates and the actual costs. Cal Am's recovery for ratemaking purposes shall be capped at the minimum level of Benefit Plan expense calculated according to the Employee Retirement Income Security Act minimum funding levels."[268]

Upon further consideration and consistent with this last decision, DRA recommends that the Commission continue to authorized "capped" recovery at minimum funding levels for ratemaking purposes. In light of the fact that the Employee Retirement Income Security Act ("ERISA") has been updated by the Pension Protection Act

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[266] California American employees receive a contribution-based calculation while Service Company pension expense is based upon a Generally Accepted Accounting Principles based calculation.

[267] Exhibit DRA-31, pages 6-1 and 6-2.

[268] D.10-06-038, p.50

("PPA"), DRA recommends capping recovery at minimum funding levels allowed by the PPA updates to ERISA. In making this recommendation, DRA recognizes with the PPA updates, that minimum funding levels are significantly higher than in prior years under ERISA, which is a generous concession to Cal Am.

Nonetheless, Cal Am ignores the funding cap, even though it is raised by the PPA, which is demonstrated by the fact that its own expert witness claims ignorance of the law on which the expense request is directly based.

DRA's auditor Overland conducted discovery to actually examine the basis for Cal Am's substantial requested increase in California pension expense. Specifically, Cal Am's requested expense for California is based on the following total forecasted cash contributions for American Water, projected as of April, 2010:[269] See the table below.

Table 12
Forecasted Cash Contributions for American Water Service Company Projected as of April 2010.[270]

2010	$81.2 milliion
2011	$109.8 million
2012	$118.4 million
2013	$91 million
2014	$86.2 million

This table is noteworthy for several reasons. First, although the calculations were ostensibly made by Cal Am's actuary, this cannot be confirmed because the actuary is not referenced anywhere on the worksheet or on the narrative data response to which the worksheet was attached. In addition, the actuary was not offered as a witness to support the calculation.

[269] Exhibit DRA-28, "Cal Am Data Response to Data Request OC-241, Attachment p.1, American Water Pension Plan, 5 Year Contribution Estimates – April 2010, "Total Fiscal Year Contributions".

[270] Exhibit DRA-28, "Cal Am Data Response to Data Request OC-241, Attachment p.1, American Water Pension Plan, 5 Year Contribution Estimates – April 2010, "Total Fiscal Year Contributions".

Second, the amounts forecasted as of February, 2010, have changed at least twice since then. The attachment included in Exhibit DRA-28 also includes the more recent forecasts, which were made in November, 2010 and February, 2011. The February, 2011 worksheet forecasts the following minimum funding requirements for American Water, as shown in the table below.

Table 13
Forecasted Cash Contributions for American Water Service Company Projected as of February 2011[271]

2011	$93.5 million
2012	$93.9 million
2013	$84.5 million
2014	$50.2 million
2015	$32.6 million
2016	$32.9 million

As the February, 2011 forecast shows, average minimum contributions are much lower than the $118.4 million on which Cal Am's request is based. Specifically, the average ERISA (PPA) minimum contribution in the February, 2011 actuarial calculation is $64.6 million for the period 2011 through 2016, slightly more than half of the $118.4 million on which Cal Am's pension expense request for the years 2012 through 2014 is based. Although still somewhat higher than the $54.3 million actuarial estimate of 2012 FAS 87 pension expense,[272] the $64.6 million average minimum contribution over the next six years is much more in line with the GAAP calculation than Cal Am's request, and much more reflective of the bounce-back that has occurred in the equity markets than indicated by the amount Cal Am has requested.

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[271] Exhibit DRA-28, "Cal Am Data Response to Data Request OC-241, Attachment p.1, American Water Pension Plan, 5 Year Contribution Estimates – April 2010, "Total Fiscal Year Contributions".

[272] Exhibit DRA-31, pages 6-1 and 6-2.

d) DRA Recommends Test Year, Escalation Year and Attrition Year Pension Expense Based on an Average of Projected Minimum Funding Requirements Under the Pension Protection Act for the Period 2011 Through 2016

DRA recommends that average of projected minimum funding requirements under the Pension Protection Act for 2011 through 2016 be used as the basis of pension expense for test, escalation and attrition years. Post-report discovery and analysis performed by Overland produced the February, 2011 minimum pension funding estimates discussed above.[273]

DRA recommends that the Commission use this methodology as the basis for establishing the level of pension authorized in rates. DRA further recommends that beginning with the next rate case, one method, minimum funding, be used as the basis for rate-authorized pensions for both Cal Am and Service Company employees.[274] However, rather than using a point estimate taken at the time forecasted minimum funding is expected to peak (the $118.4 million 2012 projection implicit in Cal Am's request), DRA recommends that authorized pension expense for test year 2012, escalation year 2013 and attrition year 2014 be based on the average minimum funding requirement over the six-year period 2011 through 2016, using the more recent February, 2011 calculation.[275]

In its report, DRA's auditor Overland recommended the Commission authorize base period pension expense equal to the GAAP amounts expensed in the base period and the GAAP amounts forecasted by Cal Am's actuary for the years 2011-2013.[276] These amounts, and the forecast for attrition year 2014, are shown below:

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[273] Exhibit DRA-28

[274] DRA does not recommend the Commission attempt to change the FAS 87 (GAAP-based) pension expense currently reflected in this rate case; however, Cal Am should calculate Service Company and Cal Am pension expense using the same contributions-based method in future cases.

[275] The February 2011 calculation is shown on Exhibit DRA 28, and recognized by Cal Am

[276] Exhibit DRA-31, pages 6-3 and 6-4

Table 14
Actual 2010 and Forecasted 2011-2014 GAAP Pension Expense, Per American Water's Actuary[277]

2010	$67.3 million
2011	$61.5 million
2012	$54.3 million
2013	$47.5 million
2014	$41.5 million

It was subsequently determined by DRA that at the time of its report Overland was unaware of the balancing account that had been authorized in Decision 10-06-038 or the settlement that had been reached between Cal Am and DRA capping the level of pension in rates at the ERISA minimums. This average amount is $64.6 million for American Water as a whole.[278] As discussed below, the amunt of expense attributable to Cal Am employees, after capital credits, is $2,393,000.

DRA recognizes that the Commission could adopt the GAAP pension expense contribution, as recommended by DRA's independent consultant, as an alternative. Because it is a recommendation by DRA's independent consultant, DRA would support this approach as a second alternative. However, DRA believes that adopting its preferred approach maintains consistency with the method adopted in the last general rate case.

Regardless of which approach the Commission adopts, DRA believes that both approaches are far more accurate than Cal Am's requested, but unexplained, $118.4 million forecast for 2012 California pension expense. In particular, DRA's preferred approach updates Cal Am's April, 2010 point estimate (on which Cal Am's calculation is based) to February, 2011, thus reflecting the continued recovery in the equity markets that occurred during the intervening months. Also, by averaging the projected minimum funding requirements, DRA's preferred approach avoids the problem of carrying a

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[277] Exhibit DRA-31, pages 6-1 and 6-2

[278] This can be determined by taking an average of the February, 2011 amounts presented in the table above.

$118.4 million spike in funding from a single point in time (2012) forward over the entire three-year period in which rates will be in effect. DRA strongly recommends the Commission reject Cal Am's requested level of pension rate funding for California employees, based on a $118.4 million contribution, as clearly not justified based on the facts discussed above.

Because DRA's $64.6 million average minimum funding recommendation is an amount representing American Water as a whole, it is necessary to allocate it to Cal Am using the pension allocation method employed by American Water's actuary. This allocation shows that Cal Am's allocation of minimum required pension contributions is 4.6%.[279] Thus, DRA recommends that the Commission authorize no more than 4.6% of $64.6 million annually, or $2,971,600 per year, in total pension funding for Cal Am, before capital credits, for the years 2012, 2013 and 2014.

The individual capitalization rates for the districts range from 2% (for Monterey Wastewater) to 46% (for California Corporate).[280] Overall, they average 19.46% for Cal Am as a whole, meaning the expense rate for Cal Am pensions is 80.54%. Thus, DRA recommends pension expense authorized in rates for Cal Am employees for the years 2012 through 2014 of no more than $2,971,600 x 80.54%, or $2,393,000 annually.[281] DRA's recommendation provides Cal Am with an increase of 43% over the $1,672,300 currently authorized in rates. This recommendation is more than generous for a category of expense that Cal Am did not even attempt to justify with testimony or supporting calculations.

Should the Commission choose DRA's second alternative; that is, adopt pension expense based on auditor Overland's recommendation, it is necessary to allocate the

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[279] Exhibit DRA-27, page entitled "Allocation of Projected Calendar Year 2011-2014 AWW Qualified Plan ERISA Minimum Required Contributions", Column: Allocations Percentage; Row: West Division, California (4.60%).

[280] CAL AM Exhibit A-CC, Chapter 3, table 9.

[281] Given that 19.46% is an overall weighted average for Cal Am, the capital credits and pension expense authorized for Cal Corp and to each district should be computed separately using the percentages shown in CAL AM Rate Filing Exhibit A-CC, Chapter 3, Table 9.

actuary's GAAP forecasts to Cal Am using the actuary's GAAP forecasts. Applying the 4.6% California pension allocator and 80.54% expense ratio to total forecasted GAAP expense for American Water results in the following pension expense for Cal Am (district and CalCorp) employees:

Table 15
Actual 2010 and Forecasted 2011-2014 GAAP Pension Expense, Per American Water's Actuary, Allocated to California Expense, for Cal Am Employees[282]

	Total GAAP Exp.	California GAAP Exp.	Exp. After Cap.Credits
2010	$67.3 mil.	$3.096 mil.	$2.493 mil.
2011	$61.5 mil.	$2.278 mil.	$1,835 mil.
2012	$54.3 mil.	$2.498 mil.	$2.012 mil.
2013	$47.5 mil.	$2.185 mil.	$1.760 mil.
2014	$41.5 mil.	$1.909 mil	$1.538 mil.

3. Adjustment #11 – Group Insurance

Cal Am's requested group insurance expense includes expense for all Cal Am employees (Cal Corp and the districts), as well as expense allocated from American Water Service Company. Taking California and allocated Service Company expense into account, DRA's auditor Overland established that Cal Am's initially-requested test year 2012 group insurance expense of $4,388,096 was 53.6 percent higher than group insurance expense of $2,856,830 actually recorded in 2010.[283] In rebuttal testimony, Cal Am later reduced its 2012 request to $4,010,255.[284] The revised test year group insurance

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[282] Total GAAP Expense per Exhibit DRA-31, pages 6-1 and 6-2. California GAAP expense = Total GAAP expense times 4.6% (California's share of American Water's pension expense, per American Water's actuary, as explained and referenced above to Exhibit DRA 27). Expense After Cap. Credits = California GAAP Expense times 80.54% (expense to total expenditure ratio, as explained and referenced above to CAL AM Rate Filing Exhibit A-CC, Chapter 3, Table 9).

[283] Exhibit DRA-31, Table 7-1, page 7-6

[284] Exhibit CAL AM-54, Rebuttal Testimony of Jeffrey Dana, p.18. Calculated as follows: $4,388,096 (Cal Am's original group insurance expense request for 2012), minus $377,841 ("Cal Am Proposed Adjustment [for 2012] based on actual 2011 plus 8.0%") = $4,010,255 (Cal Am Revised Group Insurance Request for 2012).

expense request, as discussed in Cal Am's rebuttal testimony, represents a 40.4 percent increase over 2010 recorded expense.[285]

As a starting point, it is important to understand the parties' positions on group insurance. Essentially, Cal Am's position is that test year group insurance expense consists mainly of health insurance and related administration costs. Even though American Water self-insures for employee health care, Cal Am describes group insurance as a cost "over which the company has little control."[286] Presumably because it "has little control," Cal Am believes it is entitled to recover whatever group insurance expense it forecasts will be incurred, regardless of how much the expense increases from year to year, and regardless of whether it properly funded its VEBA trust account in prior years. For the reasons discussed below, DRA recommends that Cal Am's group insurance expense be based on 2010 actual costs, adjusted for inflation by applying the labor and labor-related expense escalation rates reflected in Commission escalation memos, as set for in Commission Decision 04-06-018. If the Commission determines that Cal Am should recover increases in group insurance that exceed the labor inflation reflected in Commission escalation memos, DRA strongly urges that Cal Am not be permitted to recover expense increases that exceed the utility industry health insurance cost trend rate of 8.2 percent annually, applied to 2010 actual group insurance expense.

In the prior Cal Am rate case the Commission noted the following:

> Confronted with "seemingly endless" increases in administrative costs, the Commission has adopted the rate of customer growth as a guideline for evaluating proposed increases in Administrative and General Costs such as those proposed by Cal-Am in its General Office application. Although not an absolute cap, proposed increases that exceed the rate of customer growth must meet a "heavy burden" to demonstrate reasonableness.[287]

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[285] $4,010,255 / $2,856,830 = 1.40374, which rounds to an increase of 40.4%.

[286] Exhibit CAL AM-27, Direct Testimony of David Stephenson, pages 106-107.

[287] D.09-07-021, page 94.

There is no appreciable increase in forecasted customers to support the significantly higher level of group insurance expense that Cal Am requests.[288] The utility industry trend for health insurance cost was an increase of slightly more than 8 percent annually.[289] Even with the revision made in rebuttal testimony, Cal Am's request represents a compound annual rate of increase of 18.5 percent between the amount recorded in 2010 and the 2012 test year, a rate that is more than twice the cost trend for the utility industry as a whole, according to data provided by the company's human resources consultant.[290] Thus, Cal Am has not met the "heavy burden" established by the Commission to justify an increase in group insurance expense of more than 40 percent between 2010 and 2012.

a) Cal Am Now Seeks to Retroactively Recover Funds In Its VEBA Trust Account That It Failed To Collect In 2009 And 2010

American Water's group insurance expense is funded primarily through company contributions to a VEBA trust account.[291] Cal Am states that American Water did not increase the amount of company-paid group insurance costs "per employee" contributed to the VEBA since 2007 despite increasing health care costs.[292] Cal Am claims that it did not increase company-paid group insurance contributions due to "excess reserves" in the VEBA trust account.[293] In rebuttal testimony, Cal Am's witness Jeffrey Dana further

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[288] CAL AM Exhibit A-CC, Chapter 3, Table 1, page 1 shows that from 2005 to 2009, Cal Am's total number of customers has only increased from 169,720 to 171, 359. CAL AM Exhibit A-CC, Chapter 3, Table 1, page 2 shows that from 2010 to 2013, customers are only estimated to increase from 171,913 to 172,607.

[289] Exhibit DRA 21, worksheet entitled "Health Care" (Medical and Rx) Trend (Excluding AWE).

[290] The 18.5% number is the compound annual rate that mathematically results in a 40.4 percent increase over two years. In other words, 1.185 x 1.185 = 1.404225, which rounds to 40.4%.

[291] As discussed below, in 2009 American Water contributed approximately 82.2% to the total cost of health insurance, and employees, through payroll deductions, co-payments and other payments to health care providers, paid 17.8%.

[292] Exhibit CAL AM-9, Direct Testimony of Jeffrey Dana, p.25. In fact, Cal Am finally did increase the funding rate late in 2010, as it implemented 2011-budgeted funding rates a few months early (perhaps due to better-than-expected 2010 earnings forecasts).

[293] Exhibit CAL AM-54, "Rebuttal Testimony of Jeffrey Dana", page15.

claims that "[t]hese extra reserves built up due to positive claims experience reflecting cost cutting measures the Company had successfully implemented."[294] The funds Cal Am refers to as "excess" apparently resulted from a "dependent audit" that took place in 2006 or 2007 (probably, in 2007).[295] The dependent audit resulted in a one-time reduction in cost by removing ineligible dependents who had previously been receiving benefits under American Water's health insurance plan.[296] The reductions in expenses from this non-recurring event occurred primarily in 2008, the year in which insurance-ineligible dependents were removed from the insurance plan.[297] Meanwhile, however, the underlying costs for American Water employees and dependents remaining on the insurance rolls continued to increase at a rate exceeding the utility industry cost trend. In 2009, American Water reflected this reality in its budgeting process. However, American Water Service Company, Cal Am, and most likely American Water as a whole, chose to fund much less than the underlying cost trend required, as indicated by the difference between the amounts budgeted and funded for 2009.[298] As health care inflation continued in 2010, American Water and Cal Am continued to maintain the group insurance funding level established in 2007.[299] Contrary to Cal Am's assertion that it was drawing down "excess reserves," by not adjusting funding in 2009 or 2010 for underlying cost inflation, American Water was digging a hole that it now proposes to make up retroactively with an increase for 2011 and for 2012 that is more than double the underlying utility industry health care cost trend.

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[294] Exhibit CAL AM-54, page 15.

[295] May 25 Tr. 731: 24 to 732: 7.

[296] Exhibit DRA-21, as evidenced by the negative "Experience and Migration" rate for 2008, as shown in Exhibit DRA 21, worksheet entitled "Health Care" (Medical and Rx) Trend (Excluding AWE)

[297] Exhibit DRA-31, pages 7-10, table 7-4.

[298] Exhibit DRA-22 shows that the Service Company budgeted $19.9 million and funded just $15.5 million in 2009, while Exhibit DRA-23 shows that Cal Am budgeted $3.0 million but funded just $2.0 million in 2009.

[299] The reasons for not funding the budgeted amount in 2009, and not adjusting the VEBA funding in either 2009 or 2010, are unclear, but auditor Overland implies earnings management as a possible motive (Exhibit DRA-31, p.7-13).

American Water's failure to increase funding to keep up with underlying cost trends in 2009 and 2010 created a deficiency in the VEBA trust which Cal Am now seeks to make up in the form of a massive 40.4 percent increase between 2010 and 2012[300] (53.6 percent in Cal Am's initial request). For 2009 alone, American Water's health insurance VEBA trust would have had a balance approximately $20 million higher at the end of that year if American Water had funded the health insurance and the level it had budgeted for that year.[301] Continuing to fund the 2009 budgeted level for 2010, even with no increase to account for 2010 inflation, would have added another $20 million or more in 2010, leaving the trust at least $40 million higher at the end of 2010, if American Water had just funded the trust at the level budgeted in 2009. As such, at least some portion of Cal Am's proposed 40.4 percent proposed increase in test year expense represents a request to retroactively recover a deficiency in the VEBA trust account created by not funding the amounts necessary to keep up with the cost trend in 2009 and 2010.[302] Therefore, the Commission should reject Cal Am's requested 40.4 percent test year increase over 2010 expense.

b) Cal Am's Group Insurance Costs Far Exceed Average Health Insurance Costs In The Utility Industry

Apart from 2008, when the benefit from American Water's dependent audit flowed into insurance costs, American Water's group health insurance costs have exceeded the cost increase trend for the utility industry by significant percentages:[303]

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[300] This 40.4% increase is explained at the outset of this section.

[301] Exhibit DRA-31, page 7-13, lines 9-11

[302] Exhibit DRA 31-Pages 7-13 showed that the estimated the 2009 group insurance funding deficiency (actual funding compared with budget) was approximately $20 million for American Water as a whole.

[303] Exhibit DRA-31, pages 7-10 and 7-11, table 7-4,. These same amounts can also be found in the worksheets provided in Exhibit DRA-21 (Cal Am's response to data request OC-214B).

Table 16

American Water Health Insurance Annual Cost Increases – Percentages Above (Below) Utility Industry Trend[304]

	Union	Non-Union
2007 (Actual)	+9.3%	+11.5%
2009 (Actual)	+5.9%	-0.1%
2010 (Forecast)[305]	+2.6%	+1.5%

Apart from 2008, when the company realized most of the savings from the dependent audit, over the last four years American Water has managed to beat the utility industry's "C+" (average) cost increase trend only once (in 2009), for only one group of employees (Non-Union), and for that group only by a miniscule amount (1/10th of 1%). This may have as much to do with American Water's approach to health insurance management as anything else, as evidenced by the opinion of Cal Am's main rate case witness, who believes, perhaps along with American Water's management, that group insurance is a cost "over which the company has little control."[306]

By reviewing statistics American Water provided in an employee newsletter[307], DRA's auditor Overland determined that one reason Cal Am's health insurance costs seem to exceed the industry cost trend is that in recent years American Water employees contributed only about half, as a percentage of total gross cost, of the health care costs paid by employees in the average utility.[308] In 2009, employees of the average utility

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[304] Exhibit DRA 31, page 7-11, table 7-4.

[305] These amounts exclude an additional 1.5 percent increase applicable to union and non-union employees, attributed to "mental health parity."

[306] Exhibit CAL AM-27, Direct Testimony of David Stephenson, pages 106-107

[307] Exhibit DRA-31, Overland Report, page 7-14, Chart, American Water Historical Costs: 2007-2009

[308] As discussed in Exhibit DRA-31, page 7-9, "gross cost" includes the total cost of benefits and the cost of administration. The total cost of benefits includes 1) contributions to the insurance plan by the company, 2) contributions to the insurance plan by employees (payroll deductions), and 3) employee out-of-pocket payments for health care provided under the plan, which include deductibles and co-payments. This portion of the report comes from review of statistics in an employee newsletter dated August 12, 2010.

paid 32.2% of gross health care costs, while employees of American Water paid only 17.8% of gross costs, slightly more than half the amount paid by the average utility employee.[309] The relatively low percentage of total health care costs paid by American Water's employees (compared with other companies) may well contribute to American Water's relatively high, and perhaps less efficient, use of health care services (as reflected in the "experience and migration" component of the company's health care cost trend). This may go a long way toward explaining why Cal Am assumes (incorrectly) that group insurance expense is a "cost over which the company has little control." In an era when all Americans are being asked to control their health care expenditures, and when lowering health costs is an explicit goal of the national health insurance statute passed by the Congress in 2010, Cal Am's passive stance towards this issue is inappropriate and should not be condoned by the Commission.

c) The Commission Should Disallow Cal Am's "Additional Requested Group Insurance Expense" Because That Is A Double-Counting of Health Insurance Inflation

Another issue with the Service Company component of group insurance expense is that Cal Am's request effectively escalates an already escalated group insurance expense forecast. In rebuttal testimony, Cal Am denies this[310] but it is abundantly clear from the record that it is so, as shown in the following table.[311]

[309] These percentages can be computed from the graph on page 7-14 of the Overland report (Exhibit DRA-31), which, as referenced in the report, comes from an employee newsletter dated August 12, 2010.

[310] Exhibit CAL AM-56, Rebuttal Testimony of David Stephenson, page 36, lines 4-19.

[311] Exhibit DRA-31, Table 7-2, page 7-7

Table 17[312]

CalAm's Revenue Requirement for American Water Service Company Impact of Group Insurance Inflation Request on Overall Composite Inflation Request						
Year	Starting Amount	Composite Inflation Rate Using DRA Memo (1)	AWSC Request Using DRA Composite Inflation Rate	Additional Requested Group Insurance Expense	AWSC Request With Additional Grp Ins Expense	Composite Inflation Rate w/ Additional Grp Ins Inflation
2011	$ 229,906,514	3.10%	$ 237,034,510	$ 4,219,316	$241,253,826	4.94%
2012	237,034,510	3.12%	244,430,909	5,402,376	249,833,285	3.56%
2013	244,430,909	3.04%	251,862,560	6,720,416	258,582,976	3.50%
Source: CalAm's AWSC Revenue Requirement Workbook, Sheets SC WP 103R, SC WP104R and SC WP 105R						
(1) April, 2010 Escalation Memorandum						

Note that the starting amounts, e.g., $229.9 million for 2011, include all Service Company costs, including group insurance expense.[313] The starting and ending amounts (i.e. amounts in the "Starting Amount" and "AWSC Request with Additional Grp Ins Expense" columns) can be traced directly to Cal Am's Service Company workpapers, proving that the math in between explains the inflation impacts on the amounts.[314] As shown, the starting Service Company total expense amounts, which include group insurance expense, are subject to inflation using escalation rates of 3.10%, 3.12% and 3.04% for 2011, 2012 and 2013, respectively. Then, on top of these escalations, Cal Am requests separate inflation of group insurance expense, as shown in the column "Additional Requested Group Insurance Expense."[315]

In rebuttal testimony, Cal Am has proposed to slightly adjust these amounts.[316] The essential point made clear by the table is that there are two layers of group insurance

[312] Exhibit DRA 31, page 7-7, table 7-2.

[313] Note that these amounts are American Water Service Company totals, before allocation to Cal Am. Cal Am's share of the amounts is approximately 5.2 percent.

[314] For example, the 2011 "Starting Amount" can be found in Cal Am's Service Company workpapers at SC-WP102 (page 17). The ending amount (in the "AWSC Request With Additional Grp Ins Expense" column) for 2011, $241,253,826, can be found at SC-WP1-3, p.22. The ending amount for 2012, $249,833,285, can be found at SC WP104, p.27. The ending amount for 2013, $258,582,976, can be found at SC-WP105 (page 32). As of the time of this brief, Cal Am had not labeled its workpapers as an exhibit.

[315] The "additional amounts", added in addition to composite inflation applied to all Service Company expenses, can be traced to Cal Am Service Company workpaper SC WP110, page 92. As of the time of this brief, Cal Am had not labeled its workpapers as an exhibit.

[316]. These requested increases were adjusted downward by small amounts in rebuttal testimony. As

expense inflation: the layer associated with escalation factors applied to the total Service Company expenses (including group insurance expense), and the separate inflation applied only to group insurance expense, ostensibly based on the amounts required to replenish and maintain a sufficient balance in the VEBA insurance trust account.

The impact of the double counting group insurance inflation on the overall composite inflation rate requested for total Service Company costs is reflected in the last column of the table from Overland's report, as shown in the table above. If the Commission does nothing else to adjust Cal Am's requested group insurance expense, it should, at the very least, require Cal Am to remove group insurance expense from the Service Company expense to which composite escalation factors are applied, because the amounts as requested by Cal Am are based on the application of escalation factors to already inflated expense.[317] However, as discussed above, DRA recommends the Commission limit group insurance increases to the labor escalation rate, which, in the case of the Service Company's group insurance expense, means denying Cal Am's request to recover all of the amounts reflected in the column titled "Additional Requested Group Insurance Expense" in the table above, to the extent they are allocated to California.

4. Business Transformation

DRA concedes that the business transformation system should be allowed in Cal Am's overall revenue requirement, but only under the following conditions. First, total project costs should be limited to no more than the estimate the Service Company has provided. Second, the Commission should impute at least a 5.3% reduction in the costs

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shown in a table contained in Cal Am Exhibit CAL AM-54 (Rebuttal Testimony of Jeffrey Dana), page 18, Cal Am has proposed to reduce its requested additional group insurance increases by $317,871 for 2011 (to $3,901,455 total), by $377,841 for 2012 (to $5,024,535 total) and by $465,331 for 2013 (to $6,255,085 total).

[317] For example, if the Commission were to grant Cal Am a group insurance inflation rate of 8.2% (the industry trend) for 2011 and 2012, the Commission should explicitly recognize in its order that 3.10% (for 2011) and 3.12% (for 2012) of this 8.2% inflation is already reflected in the Service Company schedules for 2011 and 2012, which, as shown in the table, apply a composite inflation rate to the entire Service Company management fee (which includes Service Company group insurance expense).

that would otherwise be allocable to American Water's regulated operations and to Cal Am to recognize the benefits of business transformation that inure to its parent company's market-based affiliates. Third, tangible project cost savings, as identified and quantified by American Water in its presentation to the board of directors, should be imputed in the form of a credit (expense offset) based upon estimates provided in the record.

a) Project Costs Should Be Limited to No More Than the Estimate the Service Company Has Provided

XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXX[318] Moreover, the Service Company's vendor, Accenture, signed a contract to deliver all of its business transformation services for the cost it provided in its request for proposal.[319] XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXX.[320] Notwithstanding Cal Am's belief that it should be authorized an extra $37 million beyond to provide for unsubstantiated contingencies,[321] Cal Am should be held to its statements on the record that it can stay within budget,[322] particularly given the huge price tag. Ratepayers must be able to rely upon such assurances for the cost of the system just as they rely in advance upon the cost of groceries before paying for them.

XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXX.[323] XXXXXXXXXXXXXXXXXXXXXXXXXXXX

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[318] May 26 Tr., 898: 2-21.

[319] May 26 Tr., 946: 18 – 947: 7.

[320] May 26 Tr., 872: 27 – 873:5.

[321] May 26 Tr., 893: 4-19.

[322] May 26 Tr., 898: 2-21.

[323] Exhibit DRA 29C, Page 12; May 26 Tr. 892: 18-21; Exhibit DRA 31, Page 2-26.

XXXXXXXXXXXXXXXXXXXX.[324] Cal Am's share of the amount currently budgeted is approximately $14 million.[325] The approximate impact of including BT in revenue requirements, by year, is shown in the table below.[326]

Table 18
Approximate Revenue Requirement of Business Transformation[327]

Year	Revenue Requirement
2010 (Base Year)	343,000
2011	$836,000
2012 (Test Year)	1,645,000
2013	1,827,152
2014	$2,800,000

Accordingly, DRA recommends the Commission limit the amount to be included in rates for BT at no more than American Water's estimate of $280 million or the amount to be allocated to Cal Am at $14 million.

b) The Commission Should Impute At Least A 5.3% Reduction In Business Transformation Costs That Would Otherwise Be Allocable To American Water's Regulated Operations And To Cal Am To Recognize The Benefits Of Business Transformation That Inure To Its Parent Company's Market-Based Affiliations

In the past, the Commission has authorized an amount significantly less than a regulated water company requested to fund a computer system.[328] One reason for doing

[324] Exhibit DRA 29C, Page 11.

[325] Exhibit DRA 31, Page 2-26.

[326] These numbers were developed by DRA's independent auditor, Overland consulting.

[327] Exhibit DRA 31, Page 2-27.

[328] D.07-11-037, Page 50. In that case, the Commission only authorized $2.983 million of the company's

so was because of the question about how much of the new system's capacity would be used for the company's non-regulated affiliates.[329]

Cal Am has acknowledged that its parent company's market-based affiliates could use part of the business transformation systems. It also noted that such affiliates who use the systems will be billed a portion of the fully loaded costs of BT and any ongoing maintenance on a fee basis, and those fees would be credited to the regulated utility companies through a credit or reduction in Service Company fees. The company has also acknowledged that charging a share of BT costs to the market-based operations will reduce the overall costs to regulated operations.[330]

The internal functions served by the business transformation systems (accounting, management, customer service) are primarily Service Company functions. For the most recent recorded year, 2009, Service Company charges to non-regulated affiliates were $11,672,065 out of $217,704,726 in total Service Company charges (5.36%).[331] For 2012, charges to non-regulated affiliates are forecasted to be 5.30% of total Service Company charges ($13,695,429 out of total forecasted Service Company charges of $258,582,976).[332]

Based on this cost-allocation estimate of the overall benefit of Service Company activities derived by market-based affiliates, DRA recommends that the Commission impute *at least* a 5.3% allocation of total business transformation systems cost to the company's market-based segment. This can be accomplished by reducing Cal Am's authorized allocated share of both total business transformation systems rate base and

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total $9.1 million request.

[329] D.07-11-037, page 50.

[330] Exhibit CAL AM-56, page 82.

[331] Exhibit CAL AM A-SC, Chapter 3, Section 1, Table 7. In particular, tables 3 through 11 of this exhibit show actual and forecasted total Service Company charges for the years 2005 through 2013, with breakouts between amounts charged to regulated and non-regulated affiliates.

[332] Id. at Table 11.

total business transformation depreciation expense by 5.3% to reflect the imputation of an allocation of business transformation to market-based affiliates.

c) Project Savings Should Be Imputed Immediately Based Upon Estimates Provided In The Record

Cal Am claims that savings estimates would be preliminary.[333] Cal Am's reasoning for this is that it cannot begin to achieve cost savings from business transformation until the systems are fully functional and employees have become fully acclimated to them.[334]

However, the record shows that future savings can be imputed now because they can be reasonably quantified now. A cost benefit slide ("slide") provided to American Water Service Company's board of directors[335] was recognized several times in hearings as showing savings, including by the Service Company's witness.[336] [337] Indeed, the Service Company's witness acknowledges there have been no updates to the savings identified in this slide,[338] suggesting there are cost savings identified in the slide, and that they remain the same.

As acknowledged by the Service Company's witness, the slide shows that benefits for the "Enterprise Resource Planning" ("ERP") portion of the business transformation project begin as soon as the fourth quarter of 2012.[339] As shown by this slide, XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXX[340]

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[333] Exhibit CAL AM-58, page 9.

[334] Exhibit CAL AM-56, page 77.

[335] This slide is shown on Exhibit DRA-29C, page 12.

[336] May 26 Tr., 886: 4 to 887: 12; May 26 Tr., 889: 2-11.

[337] XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

[338] May 26 Tr., 890: 3-13.

[339] May 26 Tr., 887: 17-22.

[340] Exhibit DRA 29C, page 12.

The Service Company's witness also acknowledged that the slide shows that benefits to the "Customer Information System" ("CIS") begin as soon as the fourth quarter of 2014.[341] As shown by the slide, XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXX[342] Finally, the slide states XXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXX"[343] XXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX.[344]

As noted by DRA's independent auditor, quantifiable benefits can be seen through lower labor costs, which are achieved through full time employee ("FTE") reductions.[345] XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX.[346]

For example, TURN has reasoned that if done prudently, the business transformation system will enable automatic processes that are currently done manually, thereby resulting in saving labor costs and other potential savings and reductions.[347]

XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX These quantified savings should be imputed now XXXXXXXXXXXXXX XXXXXXXXXXXXXXXX. The imputed savings should be incorporated into the revenue requirement as a credit to offset the costs of business transformation (return,

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[341] May 26 Tr., 888: 24 to 889: 1.

[342] Exhibit DRA 29C, page 12.

[343] Exhibit DRA 29C, page 12.

[344] Exhibit DRA 29C, page 12.

[345] Exhibit DRA 31, page 4-9.

[346] Exhibit DRA 29C, page 12.

[347] Exhibit TURN-2, page 28.

taxes and depreciation on the business transformation investment added to rate base) that are included Cal-Am's revenue requirement.

d) Pre-Tax Return

DRA retained the pre-tax return for the General Office ratebase that is allocated to districts, which includes business transformation. The pre-tax return amount is 11.26%.[348]

e) Special Request #11-Cal Am's Business Transformation Memorandum Account Request

DRA recommends that the Commission reject the request for the proposed balancing account.

On April 7, 2009 Cal Am submitted advice letter 744 requesting a memorandum account to track all the costs of the Business Transformation Program ("Program"). The advice letter was rejected by the Division of Water and Audits ("DWA") on April 28, 2009 because the Program costs were determined to be within the control of AWW. DWA also concluded that the costs were not exceptional in nature and were more like standard operating expenses that could be reasonably forecasted. Furthermore, DWA was unable to discern any ratepayer benefits as alleged by Cal Am in its advice letter.[349]

Cal Am is now requesting a balancing account to, as discussed above, to track the difference between costs approved in rates to implement the Program and actual expenditures. For the reasons explained below, DRA recommends rejection of this special request.

(1) A Balancing Account Is Not Necessary

The Commission has approved balancing accounts for items of expense and revenue *out of the control* of the utility and therefore, difficult to forecast with reasonable

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[348] Exhibit CalCorp A, Chapter 2, Table 2.

[349] Exhibit DRA 13, pages 2-2 and 2-3.

accuracy. There is a distinction between the type of balancing accounts that the Commission has approved (purchase power, purchase water, and pump expense) and the balancing account that Cal Am is requesting.[350]

Balancing accounts for expenses such as purchase power, purchase water, and pump fees are appropriate given these type of expenses are variable and (sometimes even unpredictable) because they are determined by a separate, independent, third-entity that is undeniably outside of the utility's control. However, Cal Am's Program expenses are under the utility's control and are not as the variable expenses that are tracked in balancing accounts.[351]

Cal Am acknowledges that there are no specific laws or other regulatory mandates requiring the proposed technological changes. This means that the decision to make the changes is a discretionary business decision, and the attendant costs are normal, and under the control of AWW. Therefore, these costs can be reasonably forecasted, eliminating the need to shift forecast risk to ratepayers. Cal Am asserts that they do not expect significant cost over or under runs. DRA interprets this to mean that Cal Am expects the costs to be reasonably forecasted in this general rate case, thereby eliminating the need for a balancing account. Cal Am's assertion also implies that it expects to manage efficiently the implementation of the Program. [352]

Balancing accounts shift forecast risk between stockholders and ratepayers. Whenever actual costs are higher than the forecasted amounts, the balancing account assures that the party at risk (ratepayers) pays the difference. Conversely, if actual costs are lower than the forecasted amounts, ratepayers are refunded the difference. DRA is concerned that inappropriate requests to establish balancing accounts will have the unfortunate consequence of transferring more and more regulatory risk from utilities' shareholders to ratepayers. This is because utilities may not have an incentive to control

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[350] Exhibit DRA 13, page 2-3.

[351] Exhibit DRA 13, page 2-3.

[352] Exhibit DRA 13, pages 2-3 and 2-4.

costs knowing that ratepayers are at risk for higher than expected costs. For example, while Cal Am and AWW have control over the Program's costs, there is little incentive to mitigate cost over-runs if shareholders are protected by the proposed balancing account.[353]

To a great degree, Cal Am's request for a balancing account for its Business Transformation Program is the antithesis of prospective test year ratemaking. Balancing account balances are generally recovered in base rates or in surcharges requested in Tier 1 advice letters. These advice letters are generally approved without audit. There is little opportunity to review the recorded amounts for reasonableness before the balances are recovered, unless DRA requests the opportunity to audit the balances or request for a suspension of the advice letter. Not only is Cal Am unjustifiably disregarding prospective test year ratemaking, but it is also significantly reducing DRA's ability to conduct a meaningful reasonableness review of these expenses before they are recovered in rates.[354]

(2) Ratepayer Benefits Are Cryptic

The proposed balancing account benefits Cal Am and its shareholders. However, the benefits to ratepayers are unclear, and have not been demonstrated by Cal Am. This is because Program expenses are (1) in full control of Cal Am and AWW, (2) are not extraordinary in nature, and (3) can be reasonably forecasted. For these reasons, it is unreasonable for forecast risk to be shifted to ratepayers.[355]

Cal Am's response to DRA's Data Request JRC-2, Q.5, included the following narrative to describe "Business Transformation:"

> "Finally, Business Transformation ("BT") is more than a technology implementation project. BT is a project that will transform the business activities that matter most to the organization and marry those new ways of working with the new technology. BT will include the refinement and redesign

[353] Exhibit DRA 13, page 2-4.

[354] Exhibit DRA 13, pages 2-4 and 2-5.

[355] Exhibit DRA 13, page 2-5.

> of many of the Company's core business processes to better align business practices with the new software technologies, align customer service options with current industry practices, while helping to drive more efficient operations - all aimed at improving our ability to continue providing more effective water service and enhanced service to our customers. The new technology will give us the ability to pursue business process efficiencies by eliminating manually intensive tasks currently performed by employees. While we are not aware of any statutory or regulatory mandates that require the technology changes or process refinement and redesign, we do believe that by refining and redesigning many of our core business processes to enhance service to our customers and to realize the full potential of our new technology implementation, we are affirmatively promoting the public interest."[356]

DRA cannot discern direct, tangible ratepayer benefits from balancing account treatment of what appear to be ordinary business expenses. As described by Cal Am, the Program appears to benefit Cal Am, its employees and its company culture and DRA sees nothing extraordinary about this to warrant a balancing account. As previously stated, DRA will be presenting its findings and recommendations regarding Cal Am's request for the Program expenses in the Overland Report on General Office costs to be submitted in February 18, 2011.[357]

DRA recommends rejection of this special request because the Business Transformation Program expenses can be reasonably forecasted in this general rate case.

III. CONCLUSION

For all of the foregoing reasons, and the reasons set-forth in its testimony, DRA recommends that the Commission adopt its recommendations regarding Special Requests 4, 11, 14, 19, 24, 32, and 34. DRA recommends that the Commission adopt its recommendation to disallow the Seaside Mains and SCADA into ratebase. DRA also recommends that the Commission impute DPAD and Bonus Depreciation for Cal Am.

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[356] Exhibit DRA 13, page 2-5.

[357] Exhibit DRA 13, page 2-6.

DRA further recommends that the Commission adopt its expense estimates for labor, pension, and group insurance, as well as its methodology for calculation pension expense. Additionally, DRA recommends that the Commission adopt its recommendations with respect to Cal Am's request for a Business Transformation Memorandum Account, Cal Am's request for recovery of balances for the Monterey WRAM and MIRTU, Cal Am's recovery of additional Toro-related Goodwill, Cal Am's request for a billing system modification, and Cal Am's request to amortize all current and proposed balancing account balances in rates on an annual basis. Finally, DRA recommends that the Commission allow business transformation into ratebase, but only under the conditions it identifies above.

Respectfully submitted,

/s/ DARRYL GRUEN

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